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CÔTE D'IVOIRE

SELECTED ISSUES

May 11, 2016

Approved By
Abebe Aemro Selassie

Prepared by Carla Macario and Tim Willems (both AFR), and Romain Veyrune (MCM)

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Glossary

AFD	Agence Française de Développement
BCEAO	Central Bank of West African States
CFAF	African Financial Community Franc
EME	Emerging Market Economies
FAOSTAT	Statistics Division of Food and Agriculture Organization
FSDS	Financial Sector Development Strategy
FIRST	Financial Sector Strengthening Initiative
FISF	Financial Inclusion Support Framework
GDP	Gross Domestic Product
HIPC	Enhanced Heavily Indebted Poor Countries
MFI	Micro-Finance Institutions
NPL	Non-Performing Loan
UNACOOPEC	Partout Où Existe Une Coopec
WAEMU	West African Economic and Monetary Union
WDI	World Development Index
WEO	World Economic Outlook

FOSTERING SUSTAINABLE ECONOMIC GROWTH[1]

A key objective of Côte d'Ivoire's 2016–20 National Development Plan is to reach emerging market status by 2020. Sustaining the recent strong growth performance is crucial to achieving this objective. This paper examines Côte d'Ivoire's growth experience and argues that the development of a manufacturing export sector, lower income inequality, and prudent fiscal policy would strengthen the sustainability of growth.

A. Introduction

1. **A key objective of Côte d'Ivoire's 2016–20 National Development Plan is to reach emerging market status in 2020**. While there is no universally agreed-upon definition of emerging market economies (EMEs), it is generally understood that they are middle-income economies which experience strong economic growth and are well integrated into the world economy. Côte d'Ivoire is currently classified as a "frontier market" by the IMF.[2]

2. **This note aims to draw lessons for Côte d'Ivoire based on the experience of other comparable countries that are now EMEs**. Section II provides some stylized facts about growth in Côte d'Ivoire since 1970. The main factors that contribute to sustaining growth are discussed in Section III. Section IV compares Côte d'Ivoire's performance with that of several EMEs. The last section draws possible lessons for sustaining economic growth in Côte d'Ivoire.

B. Growth Performance: 1970–2015

3. **Côte d'Ivoire holds a unique place in Africa's post-independence growth experience**. As noted by the World Bank (2015), Côte d'Ivoire had high and inclusive growth rates during the 1970s, which has been generally attributed to its peace and stability, policies for a productive labor force, and favorable terms-of-trade. The 1980s brought with it a sharp decline in the terms-of-trade that led to significant real exchange rate overvaluation. The latter could not be corrected through internal adjustment thus bringing about a decade of declining income. The devaluation of the CFA franc in 1994, accompanied by complementary macroeconomic policies and structural reforms, helped to restore internal and external balances and provided the impetus for a pickup in economic growth. The resumption of growth subsequently slowed in the late 1990s when Côte d'Ivoire entered a period of political uncertainty, eventually leading to civil conflict and political tension that lasted from 2002 to 2011.

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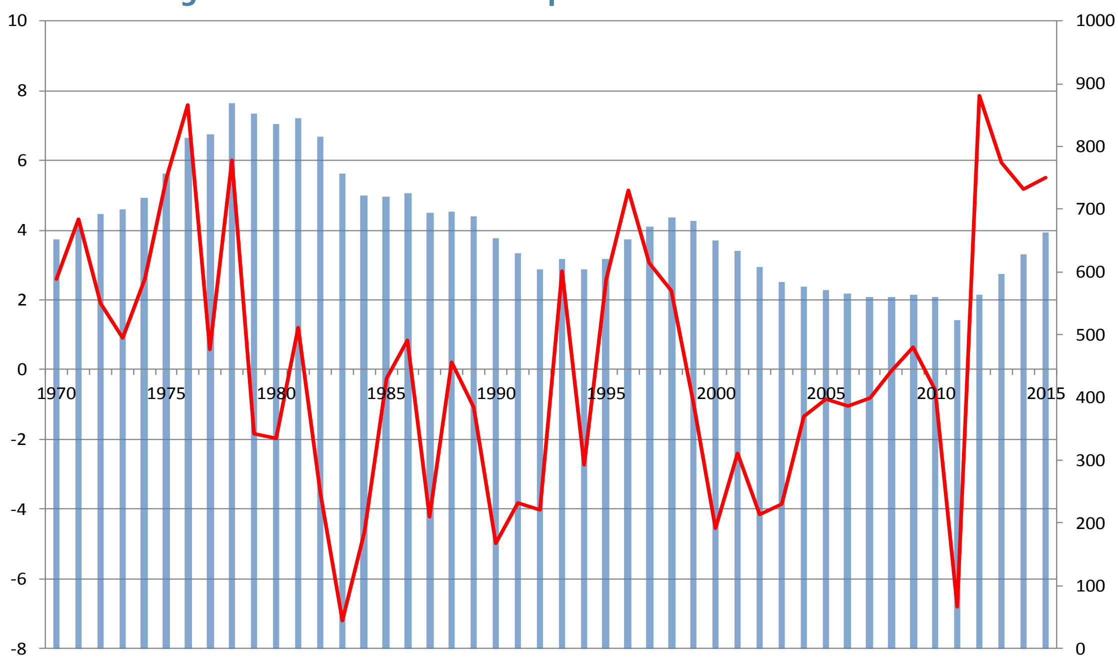
[1] Prepared by Tim Willems. This paper has benefitted from comments from Céline Allard, Dalia Hakura, and Monique Newiak.

[2] Frontier markets are countries that have been able to tap international capital markets, but have financial markets that are not as deep and liquid as those of emerging markets (https://blog-imfdirect.imf.org/2014/05/19/the-new-frontier-economies-on-the-rise/). See also IMF (2014).

4. With the return of political stability and peace, Côte d'Ivoire's economy has experienced rapid growth (Figure 1). From 2012 to 2015, average per capita real GDP growth was about 6 percent in contrast to -1.9 percent during 2002–11. The factors explaining the strong economic performance since 2011 are examined below.

Figure 1. Côte d'Ivoire: Per Capita Real GDP Level and Growth

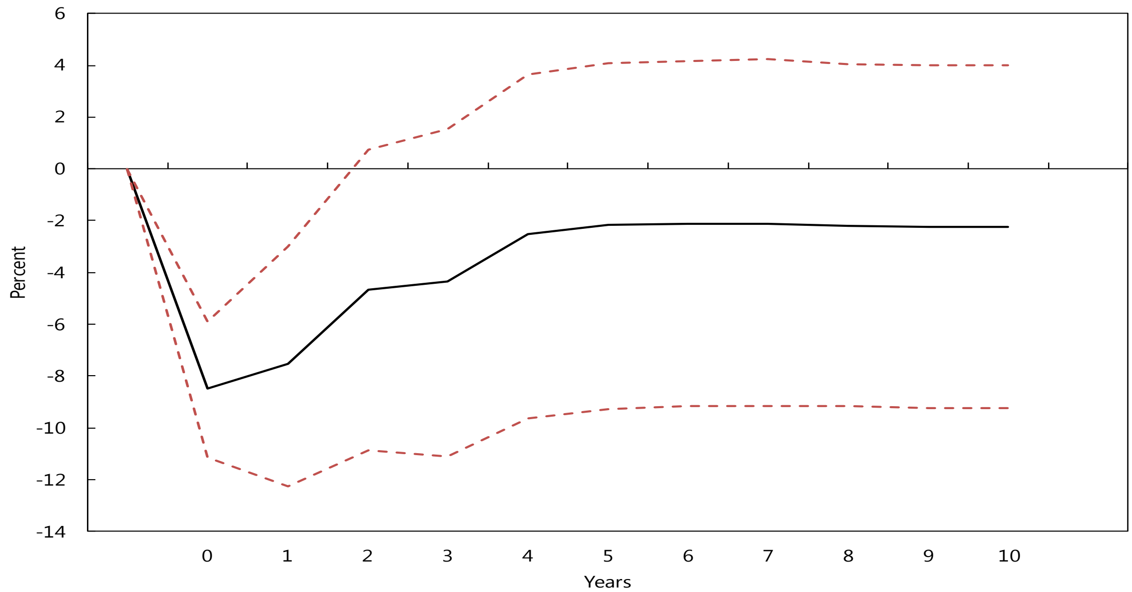


Source: World Economic Outlook database.
Note: Line indicates growth rates in percent (left axis); bars indicate levels in thousands of CFA francs (right axis).

5. The end of conflict in 2011, accompanied by policies to foster economic and social recovery, contributed significantly to Côte d'Ivoire's strong economic revival. As shown by Cerra and Saxena (2008), output typically rebounds following the end of a civil war (albeit only partially). An examination of episodes of civil conflict across the world from 1960 to 2001 shows that output first declines by 6 percent on average—mostly because of the destruction of capital.[3] About half of the output loss is regained within 4 years of the end of conflict, mostly through a rebuilding of the capital stock. The remaining 3 percent of output loss is more persistent. Limiting the analysis to African countries gives a very similar message (Figure 2).

[3] Côte d'Ivoire is fairly typical along both dimensions: real GDP per capita declined by 7.2 percent from 2002 to 2011, while a growth decomposition exercise suggests that developments in the physical capital imposed a drag on growth during the episode of conflict (Figure 3).

Figure 2. Côte d'Ivoire: Impulse Response Function for Output in Response to Civil War, Africa



Sources: Valerie Cerra; and Sweta Saxena.

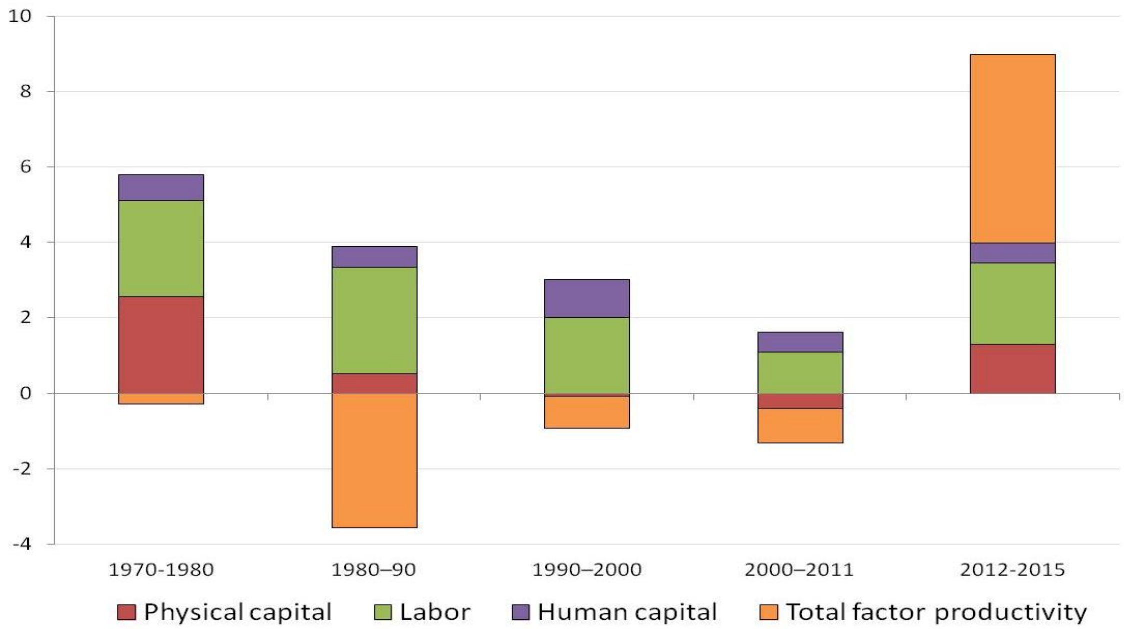
Note: Solid line represents the point-estimate (in deviations from the pre-shock trend). Dashed lines indicate 95 percent confidence bands.

6. The recent post-conflict improvement in growth in Côte d'Ivoire has been primarily driven by an increase in productivity and capital accumulation (Figure 3). Staff estimates that more than half of GDP growth during 2012–15 is explained by the growth-accounting residual, which likely reflects a catch-up in pent-up demand and a pick-up in capacity utilization, as well as improvements in productivity; the latter thanks to the government's efforts to narrow the infrastructure gap, and improve agricultural productivity and the business climate. At the same time capital accumulation turned positive and accounted for 0.8 percentage points of GDP growth during 2012–15.

7. Medium-term productivity increases can either be driven by the adoption of new technologies or by structural transformation. The latter involves the reallocation of resources from less productive sectors, to more productive ones. However, as shown by McMillan and others (2014), reallocating resources in a "productive" direction is not straightforward: they calculate that structural transformation has actually been a drag on African growth during 1990–2005 (while it stimulated growth in Latin America and Asia). Since 2000, structural change has contributed positively to economic growth in Africa.[4]

[4] The African sample used by McMillan and others consists of South Africa, Mauritius, Nigeria, Senegal, Kenya, Ghana, Zambia, Ethiopia, and Malawi. Given data limitations, their methodology cannot be applied to Côte d'Ivoire.

Figure 3. Côte d'Ivoire: Growth Decomposition



Source: IMF staff calculation.

C. How Can Growth Be Sustained?

8. **Côte d'Ivoire's strong performance in recent years begs the question of how economic growth can be sustained**. Following Pritchett (2000), there is a literature analyzing the determinants of changes in the rate of economic growth. Hausmann and others (2005) find that growth accelerations are correlated with real exchange rate depreciations and increases in investment and trade. Moreover, they find that external shocks (e.g., terms-of-trade) induce growth accelerations that eventually "fizzle out", while growth episodes that are accompanied by economic reforms (e.g., increases in trade-openness and steps to keep the exchange rate aligned to fundamentals) are more sustained. Jerzmanowski (2006) emphasizes the importance of institutions, highlighting that while weak institutions do not rule out growth takeoffs, they do tend to limit their durability. More recently, Berg, Ostry and Zettelmeyer (2012) identify four factors that contribute to sustaining growth: (i) export orientation; (ii) income equality; (iii) good political and economic institutions; and (iv) macroeconomic stability.

D. A Comparative Analysis

9. **This section compares Côte d'Ivoire with four economies that share some features of Côte d'Ivoire and have reached "emerging market" status** (see Table 1): Indonesia (the world's third-largest exporter of cocoa, after Côte d'Ivoire and Ghana), Mauritius (an African economy that has displayed strong growth performance since the 1970s), and Morocco and the Philippines (two EMEs whose levels of real GDP per capita in 1990 were similar to Côte d'Ivoire's

current level) The countries are compared with Côte d'Ivoire based on the four factors that Berg, Ostry and Zettelmeyer (2012, henceforth "BOZ") identify as key to sustain economic growth (see preceding paragraph).

Table 1. Côte d'Ivoire and Comparators[a]

	Per capita real GDP, 1990[b]	Per capita real GDP level, 2014[b]	Per capita in real GDP (average growth, 1990-2014; in percent)	Population size, 2014 (in million)
Côte d'Ivoire	3,220	3,108	-0.1	22.1
Indonesia	4,477	10,033	3.4	254.5
Mauritius	7,568	17,731	3.6	1.3
Morocco	3,933	7,146	2.5	33.9
Philippines	4,010	6,649	2.1	99.2

[a] Source: World Bank's "World Development Indicators" database.

[b] Expressed in PPP-adjusted 2011 US dollars.

D.1 Export orientation

10. Export orientation is an important driver of sustained growth identified by BOZ. Countries with higher propensities to export manufactured goods and those with a more liberalized trade system, as well as those that keep their exchange rate close to equilibrium, are able to sustain high growth rates for longer periods of time. These results are confirmed on a sub-Saharan African-specific sample in IMF (2015).

11. As regards the propensity to export manufactured goods, Côte d'Ivoire lags the four comparator countries and the average for EMEs. In contrast to the four comparator countries, Côte d'Ivoire's exports are dominated by commodities (Table 2). Moreover, unlike Côte d'Ivoire, these comparator countries (as well as the average for EMEs) managed to increase their share of manufactured exports significantly at some point between 1970 and 1990 (Figure 4).

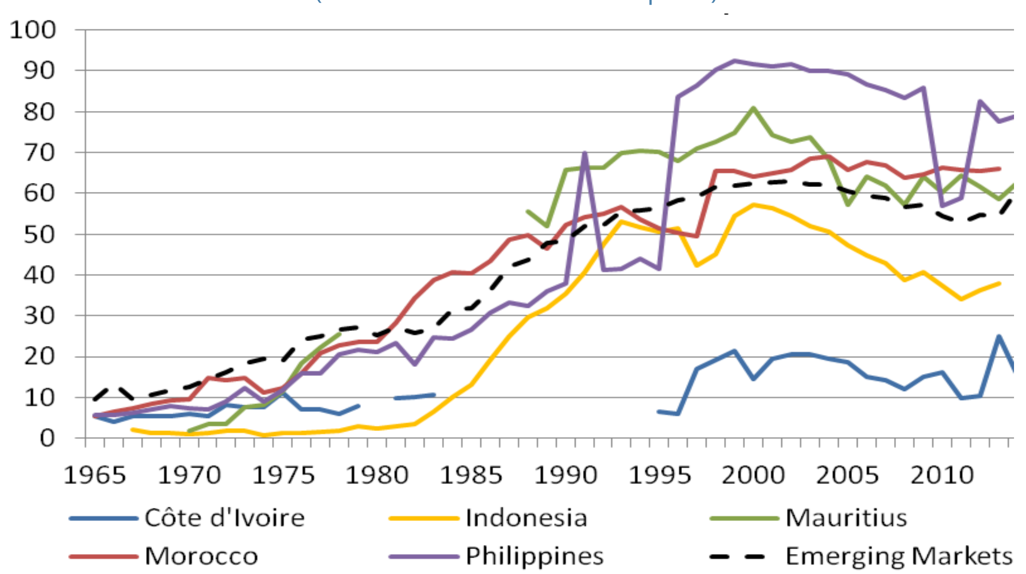
Table 2. Top Five Exports Across Countries, 2013
(Percent of total exports)

Côte d'Ivoire	Indonesia	Mauritius	Morocco	Philippines
Cocoa beans (19.6%)	Coal briquettes (11.3%)	Processed fish (14%)	Insulated wire (10%)	Integrated circuits (24.8%)
Special purpose ships (12.3%) [1]	Petroleum gas (8.6%)	Raw sugar (13.8%)	Cars (6.7%)	Computers (7.7%)
Refined petroleum (12.2%)	Palm oil (8.1%)	T-shirts (7%)	Fertilizer (5.9%)	Semiconductor devices (4.6%)
Crude petroleum (7.2%)	Crude petroleum (5.6%)	Men's shirts (6.9%)	Refined petroleum (5.6%)	Office machine parts (4.1%)
Rubber (7.2%)	Rubber (3.7%)	Men's suits (3.5%)	Phosphoric acid (5.5%)	Electrical transformers (2.9%)

Source: http://atlas.media.mit.edu/.

[1] The category "special purpose ships" for 2013 data is not representative of Côte d'Ivoire's top exports; in 2012, the top 5 exports were cocoa beans, refined petroleum, crude petroleum, rubber, and coconuts.

Figure 4. Côte d'Ivoire: Manufacturing Exports
(Percent of merchandise exports)



Source: World Development Indicators.

12. A rising exporting manufacturing sector would improve Côte d'Ivoire's growth prospects for the following reasons:

- **First, manufacturing industries display *unconditional* convergence** (Rodrik, 2013). This implies that the manufacturing sector tends to catch up with the global frontier despite possible geographical disadvantages, adverse climate conditions, or suboptimal policies. Other sectors of the economy do not share this characteristic and grow only when aided by favorable geographic factors, good institutions, and supportive policies.

In that sense, growing through manufacturing industries is relatively less-demanding and robust.

- **Second, future growth rates increase with a rising share of manufactured goods in a country's export basket**. Hausmann and others (2007) have shown that not all goods are alike in terms of their consequences for economic performance: countries that export "more complex" goods (such as manufactures) can subsequently be expected to display stronger growth than those whose exports consist of "less complex" goods (such as unprocessed raw materials).[5] The fact that an upgrade of the export-mix facilitates further structural transformation (explained below), is likely to contribute to this.

13. At present, Côte d'Ivoire's export complexity is low in relation to comparators (Figure 5). Ranked by "export complexity", Côte d'Ivoire is 98th (out of 124 countries). Indonesia ranks 72nd, Mauritius 64th, Morocco 88th, and Philippines 49th.[6] Indonesia is of particular interest, as it was very similar to Côte d'Ivoire in terms of export-complexity in 1970. Since then, however, it has improved its score by about 1.5 points,[7] while Côte d'Ivoire's score has improved by 0.5.

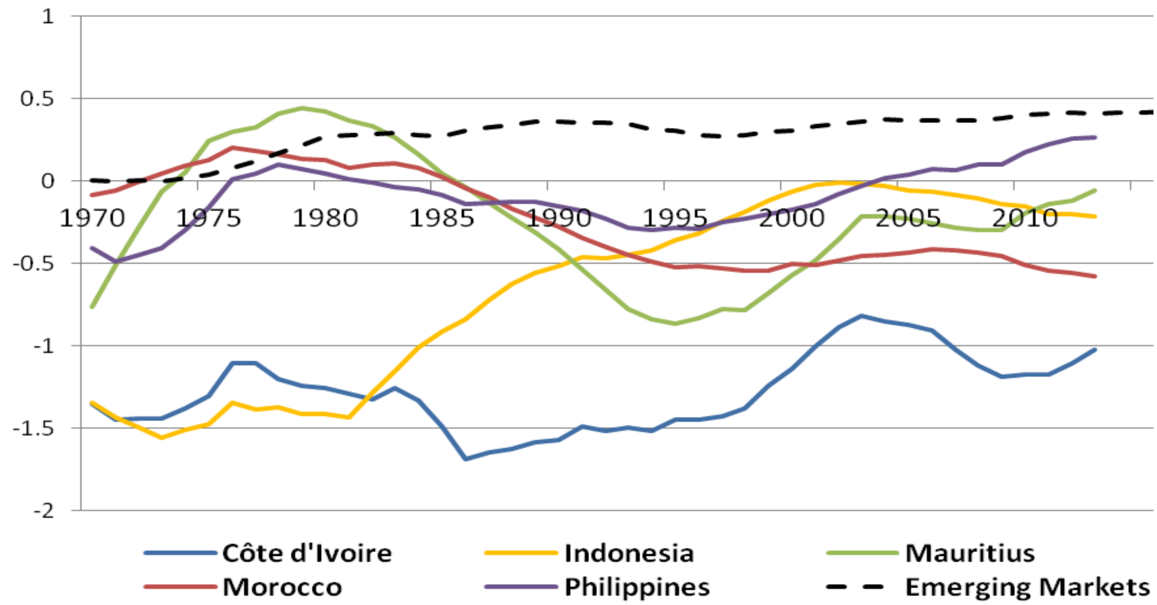
14. Côte d'Ivoire's ability to upgrade its export mix will depend on the current production structure and availability of skills. As set out in Hausmann and Klinger (2006), a change in the product mix of a country will require new skills/capabilities or inputs (e.g., product-specific knowledge, experience, machines, training) in addition to those already used for existing products. The degree of substitutability or transferability between products however differs: some capabilities play a role in the production of more goods than other capabilities. Consequently, if a country's work force has acquired capabilities with a high degree of substitutability (i.e., capabilities that are useful in many different production processes), it is in a better position to develop a new industry.

[5] Here, "complexity" is calculated by tools from network analysis. It takes into account how many countries export a particular good, the level of development of those countries, as well as the value-added in the production process. See also IMF (2014).

[6] The full ranking is available at http://atlas.media.mit.edu/en/rankings/country/.

[7] According to Goeltom (2007), Indonesia's industrialization process was initially stimulated by the oil price fall in the early 1980s and facilitated by reductions in trade barriers.

Figure 5. Côte d'Ivoire: Complexity of Exports
(5-year moving average)



Source: http://atlas.media.mit.edu/.

Note: This index is constructed such that the cross-sectional average across all countries equals 0, while the cross-sectional standard deviation is 1.

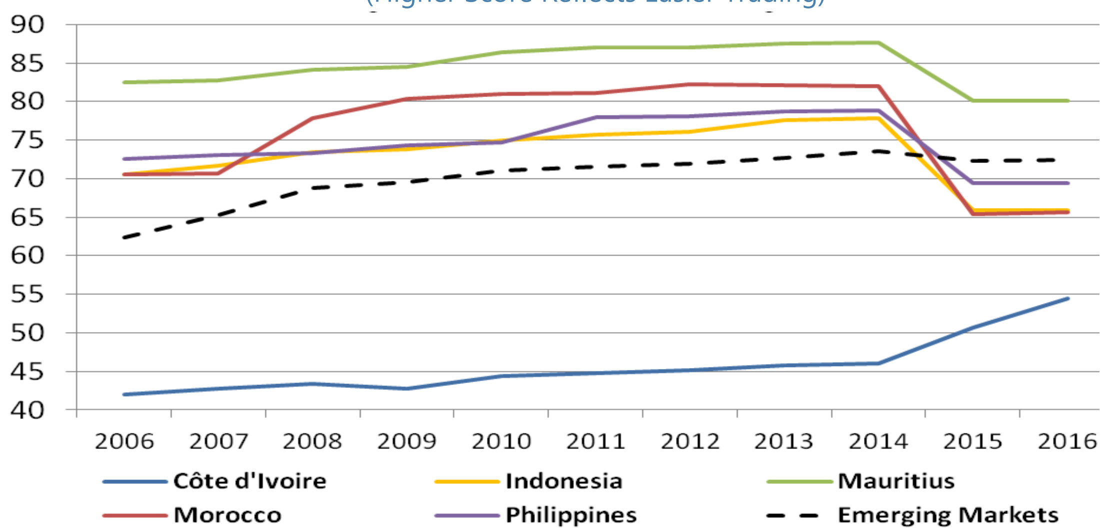
15. Activities that generate capabilities with the highest degree of substitutability are all associated with manufacturing according to Hausmann and Klinger (2006). By contrast, the production of unprocessed agricultural goods involves capabilities that have the lowest degree of substitutability. Moreover, cocoa bean production has a particularly low degree of substitutability,[8] so that the skills used in this sector tend to be product-specific and are not easily transferrable to other productive activities. Given that Côte d'Ivoire's current export-mix is predominantly cocoa-based, structural transformation into new and more complex production activities will likely require careful evaluation of needs and comparative advantage and will take time. Moreover, to allow for a gradual build-up of skills in the labor force, any transition to a more complex economy will have to occur "via" goods that have an intermediate level of complexity (even if more complex goods are more promising in terms of eventual growth outcomes).

16. To develop an exporting manufacturing sector and "upgrade" its export-mix, Côte d'Ivoire would need to address a number of challenges:

[8] From 1006 product categories, only 13 categories are associated with capabilities that have a lower degree of substitutability than cocoa-bean production. Oil extraction is another activity that is associated with capabilities that have a low degree of substitutability.

Figure 6. Côte d'Ivoire: Distance to Frontier for Trading Across Borders

(Higher Score Reflects Easier Trading)



Source: World Bank's "Doing Business" database.

Note: There is a methodological break in 2015, which implies that numbers from 2015 onwards are not directly comparable with their pre-2015 equivalents. Cross-sectional comparisons are still informative.

- The ease with which Ivoirien companies can trade across the nation's borders weighs on the competiveness of Ivoirien exporters and needs to be improved. Trading across borders has been challenging in Côte d'Ivoire relative to its peers (Figure 6). In 2014, exporting by Ivoirien firms required 9 documents and took 25 days, while it was almost half these numbers in the comparator countries on average: 4.75 documents and 13.25 days.

- To upgrade the export-mix will require a more skilled labor force. Currently, Côte d'Ivoire lags its comparators in school enrolment rates (Table 3), and improvement will require a greater investment in human capital.

Table 3. School Enrolment Rates (Secondary and Tertiary)

	Secondary enrolment rate (%)		Tertiary enrolment rate (%)	
	1990	2014	1990	2014
Côte d'Ivoire	n.a.	39.1	n.a.	9.1
Indonesia	47.3	83.1	8.5	31.5
Mauritius	52.4	95.9	3.0	41.2
Morocco	36.8	68.9	10.4	16.2
The Philippines	72.0	85.4	24.6	33.8

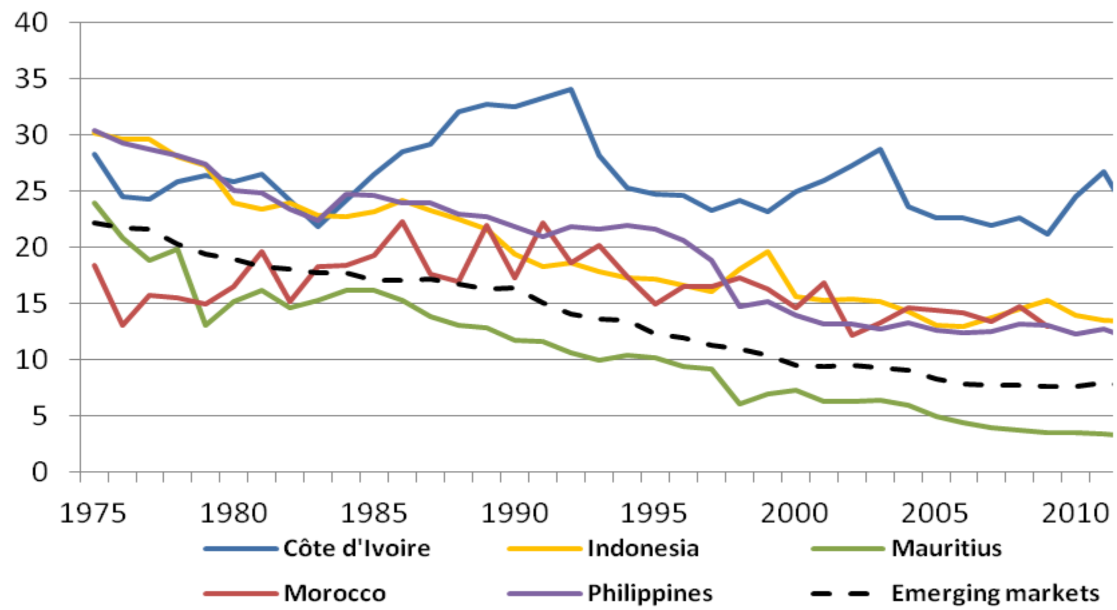
Source: World Development Indicators.

- Raising the productivity of the agricultural sector, which is labor intensive in Côte d'Ivoire, would release productive resources for other economic sectors, thereby permitting stronger growth and economic diversification (Gollin and others, 2002). All the comparator countries have higher agricultural labor productivity than Côte d'Ivoire which has permitted greater economic diversification and a reduction in the agricultural sector's share in economic output. (Figure 7).[9]

- The Ivoirien non-agricultural sector is about 5.4 times more productive than the agricultural sector, far less than in Indonesia (14.9) and the Philippines (10.9) (Table 4). This suggests that, *ceteris paribus*, structural transformation (shifting workers out of agriculture into the higher value-added secondary sector) brings smaller productivity gains to Côte d'Ivoire, than it would to Indonesia and the Philippines. This hints at scope for improvements along these lines. In particular, to achieve a larger increase in non-agricultural productivity would require further reforms to the business climate, as well as continued efforts to improve infrastructure and energy penetration.

Figure 7. Côte d'Ivoire: Share of Agricultural Value Added in GDP

(Percent)



Source: World Development Indicators.

[9] According to the FAO, agricultural value added per worker was $939 in Côte d'Ivoire in 2012 and $1215 in Indonesia, $1264 in the Philippines, and $8594 in Mauritius. More recent data are not available. Low Ivoirien agricultural productivity is likely to be influenced by the structure of the Ivoirien land market, which is to a degree characterized by insecurity over land tenure, which may hamper investment (World Bank, 2015). Significant reforms have been implemented to increase agricultural yields over the past 4 years in Côte d'Ivoire.

Table 4. Côte d'Ivoire: Total and Agricultural Output per Worker, 2012			
	Non-agricultural output per worker, in constant 2005 US$	Agricultural output per worker, in constant 2005 US$	Ratio
Côte d'Ivoire	5,035	939	5.4
Indonesia	18,136	1,215	14.9
Mauritius	30,932	8,594	3.6
Morocco	18,571	n.a.	n.a.
The Philippines	13,726	1,264	10.9

Sources: FAOSTAT; and World Development Indicators. Calculation is inspired by Gollin (2010).

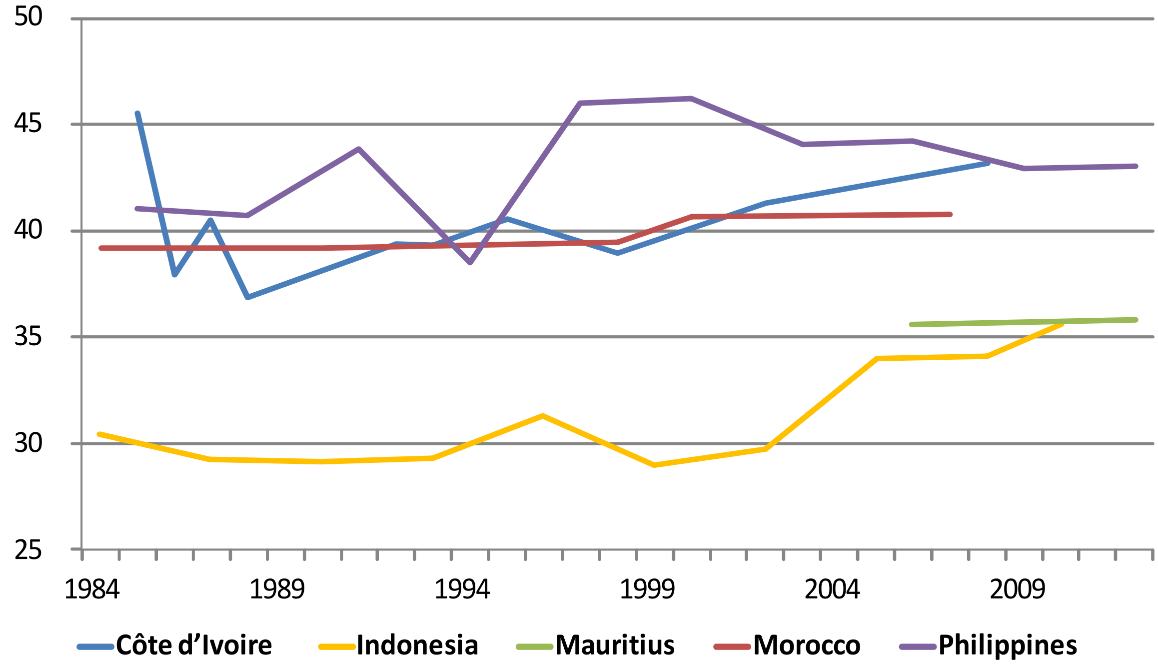
D.2 Income equality

17. Income inequality and the duration of growth spells are negatively correlated (BOZ, 2012).[10] A one percentage point increase in the Gini coefficient shortens the duration of the average growth episode by 11 to 15 percent. A likely explanation is that with imperfect credit markets, income inequality hampers the efficient allocation of resources—especially with regard to human capital investment (Corak, 2013). Côte d'Ivoire's Gini coefficient rose by about four percentage points (from 39 to 43) between 1998 and 2008 (Figure 8)[11] and the 2015 "*Enquete sur le niveau de vie des menages en Côte d'Ivoire*" suggests that the increase is being reversed, estimating the Gini coefficient at 41 for 2015.

[10] Also see IMF (2015). Focusing solely on sub-Saharan African countries, that study reports that annual economic growth in those countries could be higher by almost 1 percentage point if inequality were to be reduced to the levels observed in the fast-growing ASEAN countries.

[11] The World Bank's "World Development Indicators" database does not contain estimates of the Gini coefficient after 2008 for Côte d'Ivoire.

Figure 8. Côte d'Ivoire: Evolution of the Gini-Coefficient



Source: World Development Indicators.

18. **A more complex production/export structure contributes to declining income inequality** (Hartmann and others, 2015). This provides an additional reason for diversifying and "upgrading" Côte d'Ivoire's export mix. Hartmann and others (2015) also note that products associated with the highest levels of income inequality include "commodities such as cocoa beans" (p. 8). Products associated with lower income inequality include machinery and manufactures.

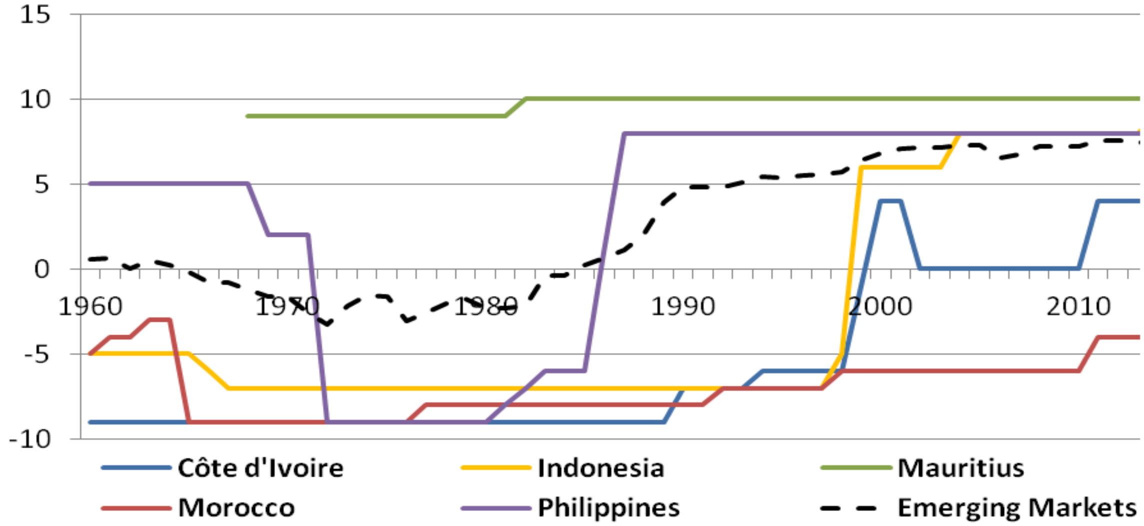
D.3 Political and economic institutions

19. **Sound political and economic institutions are a necessary condition for sustained long-run growth** (Acemoglu and others, 2001). Using the "polity2" measure of democratic institutions (on a scale of -1 to +1 from least to most democratic),[12] BOZ estimates that a one-point improvement in the polity2 score increases the expected duration of a growth spell by about 10 percent.

[12] See http://www.systemicpeace.org/polity/polity4.htm. The polity2 score is determined by the competitiveness and openness of elections, the extent of checks on executive authority, and the nature of political participation. It maps scores along these various dimensions to a one-dimensional scale. On this scale, -10 to -6 corresponds to autocracies, -5 to +5 corresponds to anocracies, and +6 to +10 to democracies.

Figure 9. Côte d'Ivoire: Development of Polity2 Scores

(Higher scores reflect better political institutions)



Source: http://www.systemicpeace.org/inscrdata.html.

20. While Côte d'Ivoire's democratic political institutions weakened during the period of civil conflict, they have improved over the past 4 years with the restoration of peace. The Ivoirien polity2 rating increased rapidly into positive territory during the late 1990s, but fell during the period of civil conflict (Figure 9). Since peace has been restored in 2011, Côte d'Ivoire's rating has improved a score of 4, on a par with the 1990s.

21. Côte d'Ivoire has made progress in improving the business environment and governance over the past 4 years, though more work remains in order to convergence towards the best performers:[13]

- Côte d'Ivoire has continued to improve its rankings in the World Bank's survey-based "Doing Business Index" moving from the 177th position in the 2014 Report (covering 189 countries) to 142th position in the 2016 report. The 2014 and 2015 reports also ranked Côte d'Ivoire among the 10 best reformers. Notwithstanding the improvements in Côte d'Ivoire's ranking on the World Bank's Doing Business Index, it lags on indicators such as ease of paying taxes and obtaining credit.

- Figure 10 compares the distance to frontier for contract enforcement (with higher scores reflecting better contract enforcement).[14] Important inputs to this score are the time and

[13] See also Annex IV of the accompanying staff report.

[14] The study by BOZ used data on contract enforcement from the International Country Risk Guide. While starting in 1984, their data ends in 2002 already. Consequently, we have used the more recent "Doing Business" database, constructed by the World Bank.

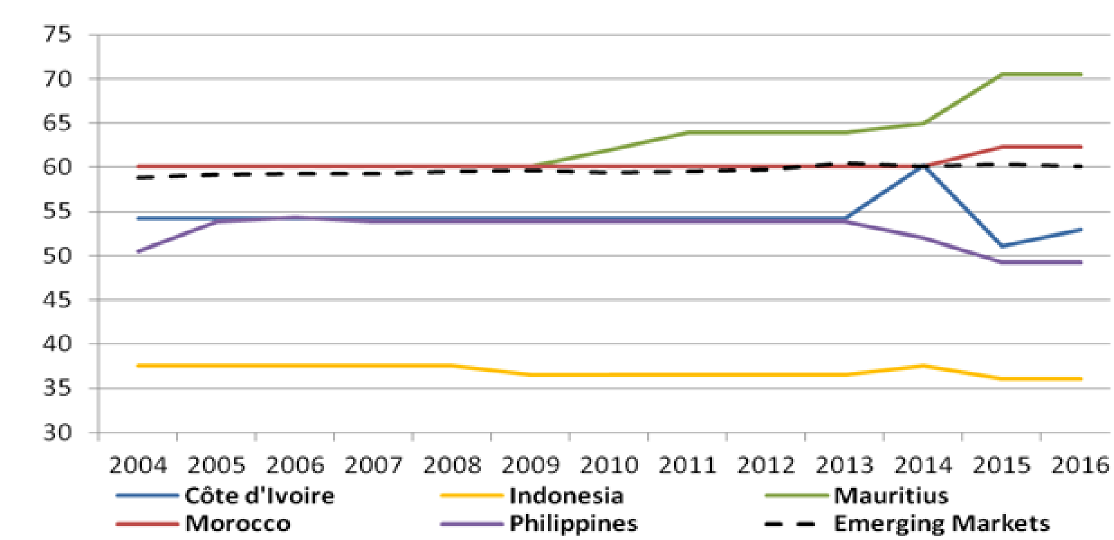
costs associated with the resolution of contract-related disputes. Resolving a contractual dispute in Côte d'Ivoire takes an average of 525 days, while costs typically amount to 42 percent of the claim (Table 5).

- Côte d'Ivoire has gained 40 positions in the Global Competitiveness Index (GCI) since the 2012–13 report. It has also advanced nine positions between 2013 and 2014 in the World Economic Forum's Enabling Trade index. Nonetheless, International trade is hampered by the high cost or delays caused by international transportation and burdensome import procedures.

- The perception of corruption is still relatively high in Côte d'Ivoire even though it has improved in recent years: the 2015 "Corruption Perceptions Index" constructed by Transparency International ranks Côte d'Ivoire 107th (out of 175 countries) compared to 136th, and is below Indonesia (88th), Morocco (88th), Mauritius (53rd), and the Philippines (95th). Côte d'Ivoire scores 48.3 (out of 100) in overall governance according to the Mo Ibrahim Index of African Governance (IIAG), below the African average (50.1) and the regional average for West Africa (52.4).[15] Although Côte d'Ivoire is within the lower half of the IIAG rankings, it has exhibited the continent's largest overall governance improvement over the past four years. Côte d'Ivoire is one of the ten biggest improvers in every category.

Figure 10. Côte d'Ivoire: Distance to Frontier for Contract Enforcement

(Higher scores reflect better enforcement)



Source: World Bank's "Doing Business" database.

[15] Higher scores are interpreted as a sign of better governance.

Table 5. Côte d'Ivoire: Days and Costs Associated with Contract-Related Disputes, 2016		
	Days	Costs (percentage of claim)
Côte d'Ivoire	525	42
Indonesia	471	116
Mauritius	519	25
Morocco	510	25
The Philippines	842	31
Source: World Bank's "Doing Business" database.		

D.4 Macroeconomic stability

22. Macroeconomic stability is an important ingredient for sustained growth (BOZ, 2012). Macro stability can be characterized as "nominal stability" (defined as price and exchange rate stability) and "fiscal stability" (avoidance of debt crises and "overheating" of the economy). Since Côte d'Ivoire is part of WAEMU, monetary policy is undertaken by BCEAO, the regional central bank. Consequently, this analysis focuses on fiscal stability.

23. The cyclicality of fiscal policy is a key contributor to overall macroeconomic stability. Following Lane (2003), an indicator for fiscal policy cyclicality is constructed from the regression below:

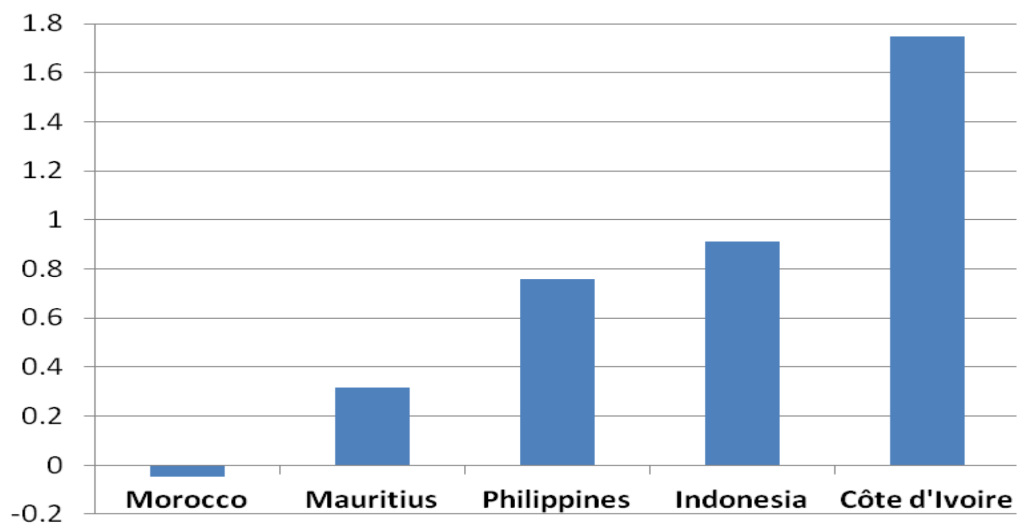
$$d(\log(G_t)) = \alpha + \beta \cdot d(\log(Y_t)) + \varepsilon_t$$

Here, G_t is real government spending in year t and Y_t is real GDP (both taken from the IMF's *World Economic Outlook* database). A positive estimate for the β-coefficient implies that fiscal policy is pro-cyclical, while a negative estimate would indicate a counter-cyclical fiscal policy. Estimates of this coefficient for the five countries of interest are shown in Figure 11.[16]

24. Fiscal policy has been more pro-cyclical in Côte d'Ivoire than its comparators. A one percent increase in Ivoirien real GDP is associated with an increase of about 1.8 percent in government spending. Such pro-cyclicality, especially if prolonged, might lead to "overheating" of the economy—and lower growth according to BOZ (2012). Commodity-exporting countries generally experience a high degree of policy pro-cyclicality (Budina and others, 2007). In Côte d'Ivoire, cocoa is a major export product, and, until 2012, so was oil (Figure 12).

[16] The available sample periods are: 1997–2015 for Côte d'Ivoire, 1993–2015 for Indonesia, 1990–2015 for Mauritius, 1990–2015 for Morocco, and 1989–2015 for the Philippines.

Figure 11. Côte d'Ivoire: Estimates of Fiscal Policy Cyclicality *(β)*



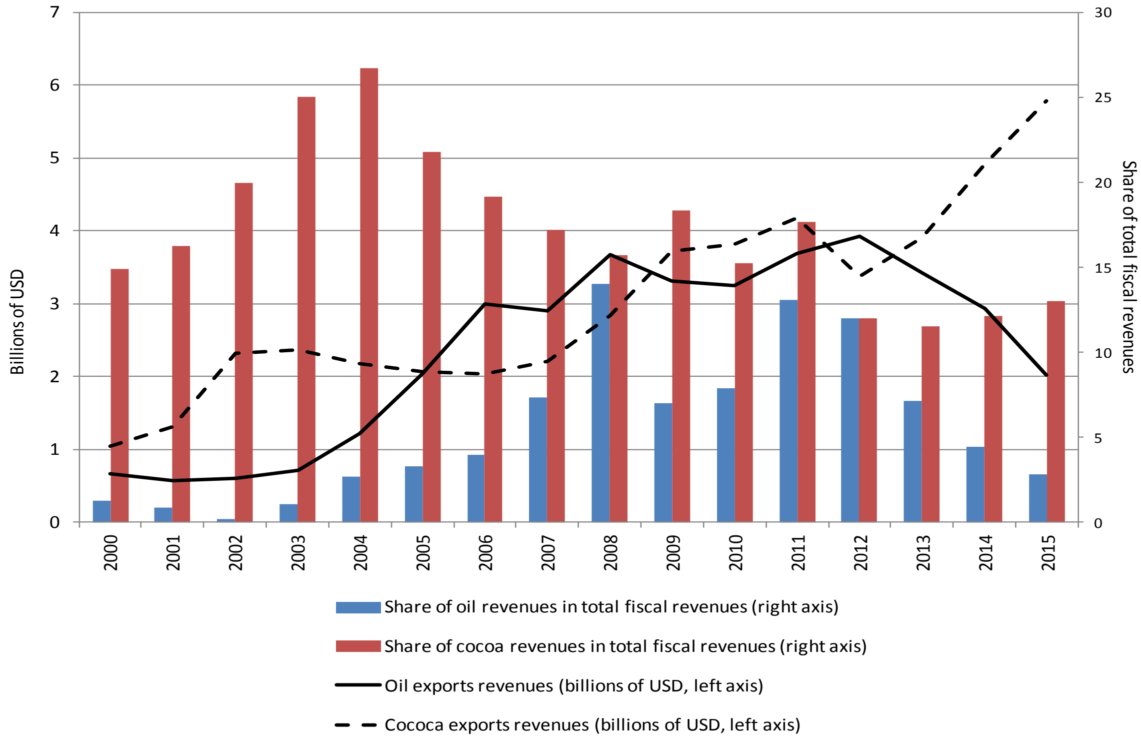
Source: IMF staff calculation.

25. Evidence suggests that fiscal policy is pro-cyclical with respect to cocoa and oil revenues in Côte d'Ivoire. The impact of cocoa and oil export revenues on public spending is examined using an OLS-regression model, following Budina and others (2007) on Nigeria:

$$\ln(G_t) = \alpha + \beta_1 \ln(XO_t) + \beta_2 \ln(XO_t) \cdot 1_{XO,t<XO,t-1} + \beta_3 \ln(XC_t) + \beta_4 \ln(XC_t) \cdot 1_{XC,t<XC,t-1} + \varepsilon_t,$$

where G_t is real government spending in year *t*, XO_t (XC_t) represents real oil (cocoa) export revenues in year *t*, and $1_{Xi,t<Xi,t-1}$ takes the value 1 if export revenues for commodity *i* are lower in year *t* compared to year *(t-1)*. Subsequently, β_1 (β_3) measures the government's propensity to spend out of oil (cocoa) export revenues, while β_2 and β_4 measure whether this response is asymmetric or not for oil (cocoa): a positive value for these coefficients implies that real government spending is *more* responsive in years of falling export revenues, while a negative value implies the opposite.

Figure 12. Côte d'Ivoire: Importance of Cocoa and Oil Revenues in Côte d'Ivoire



Source: World Economic Outlook database.

26. **Results indicate that real government spending is particularly sensitive to changes in revenues from cocoa exports**. A 1 percent increase in cocoa export revenues is associated with a 0.63 percent increase in real government spending (Table 6).

Table 6. Côte d'Ivoire: Regression Output

	$\ln(G_t)$
$\ln(XO_t)$	0.16*
	(2.85)
$\ln(XO_t) \cdot 1_{XO,t<XO,t-1}$	0.05*
	(2.23)
$\ln(XC_t)$	0.63*
	(5.14)
$\ln(XC_t) \cdot 1_{XC,t<XC,t-1}$	0.05
	(1.90)
Constant	1.04*
	(3.05)
Adjusted R^2	0.86

Source: IMF Staff calculation.

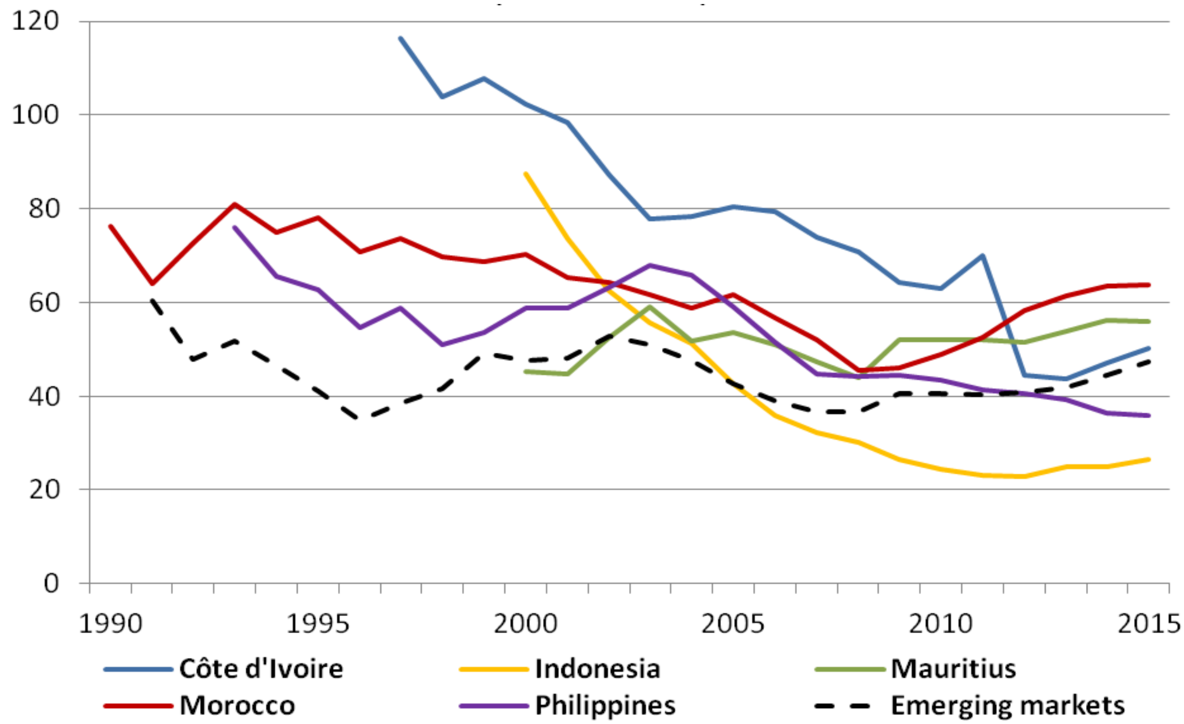
Note: T-statistics in parentheses. * indicates significance at the 5 percent level.

27. **Oil export revenues play a significant role as well, though with a smaller elasticity (0.16)**. However, the impact of oil exports is larger in years of declining revenues, when the elasticity rises to 0.21. This asymmetry, not found for cocoa, may be due to increased borrowing with oil price hikes (see Manzano and Rigobon, 2001; and Sachs, 2007). However, when oil revenues are lower than expected, the downward adjustment to government spending appears to be disproportionate.

28. **Sustained growth is also hampered by rapidly rising debt** (BOZ, 2012). The comparator countries and the average EME have managed to avoid rapid debt increases during their strong growth spell (Figure 13). Historically, Côte d'Ivoire had a relatively high debt/GDP-ratio, and following debt relief at the completion point under the HIPC Initiative and MDRI, the public debt level was lowered by about two-thirds to sustainable levels. Since 2013 the debt-to-GDP ratio has been trending up.

Figure 13. Côte d'Ivoire: Evolution of Gross Government Debt

(Percent of GDP)



Source: World Economic Outlook database.

E. Concluding Remarks

29. This paper's analysis points to a number of policy fronts along which continued progress would help to sustain strong economic growth in Côte d'Ivoire:

- *Further developing the manufacturing export sector*. Investing in human capital and improving the quality of the labor force, as well as reducing cross-border trade restrictions would be instrumental in "upgrading" the export mix and developing the manufacturing export sector.

- *Lowering income inequality*. Policies to further lower income inequality would contribute to a better allocation of (especially human) capital, thereby contributing to growth sustainability.

- *Continuing prudent fiscal policy*. Avoiding pro-cyclical fiscal policy, as well as preserving debt sustainability would improve growth sustainability.

Variable Codes

	Variable codes
Figure 1	NGDPRPC
Figure 2	pop, emp, hc, rgdpna, rkna, rtfpna
Figure 3	TX.VAL.MANF.ZS.UN
Figure 4	/
Figure 5	Trading across borders, DTF
Figure 6	NV.AGR.TOTL.ZS
Figure 7	SI.POV.GINI
Figure 8	polity2
Figure 9	Enforcing contracts, DTF
Figure 10	GGX, NGDP_D, NGDP_R
Figure 11	TXGCO, TXGO
Figure 12	GGXWDG_GDP
Table 1	NY.GDP.PCAP.PP.KD, SP.POP.TOTL
Table 2	/
Table 3	SE.SEC.ENRR, SE.TER.ENRR
Table 4	21060, SL.GDP.PCAP.EM.KD, NV.AGR.TOTL.ZS
Table 5	Enforcing contracts ("time" and "costs")
Table 6	TXGCO, TXGO, GGX, NGDP_D

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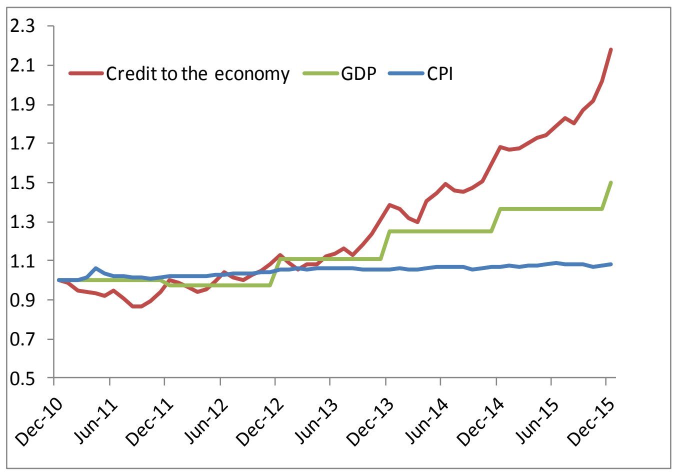
MACRO-FINANCIAL LINKAGES[1]

Credit has grown rapidly over the past three years along with strong economic growth. At the same time, overall banks' capital adequacy ratio has declined. Some public enterprises and banks face financial difficulties, the resolution of which could raise domestic debt. The financial sector could trigger a shock to the economy or reinforce the impact on the real sector of non-financial shocks. Risks to the financial sector could stem from deterioration in the external environment; non-financial shocks could be triggered in the fiscal sector. The current economic conditions in Côte d'Ivoire offer a favorable opportunity for the government to resolve the financial status of public entities facing difficulties and for banks to raise their capital buffers to be able to absorb a possible rise of non-performing loans (NPLs) in the event of a growth shock.

1. **Credit has grown sharply over the past five years along with strong economic growth**. Since December 2010 credit more than doubled, largely outpacing GDP growth, while inflation was low (Figure 1). Credit creation was facilitated by positive global conditions for Côte d'Ivoire, a favorable domestic business environment, and accommodative monetary policy at the regional level—all of which also supported the surge in economic growth. Strong economic performance, in turn, generated a positive outlook and supported risk appetite, which attracted investors in the banking sector, triggered competition for market shares, and boosted credit growth. Demand for credit by the private sector was also stimulated by the surge in public investment (Figure 2).

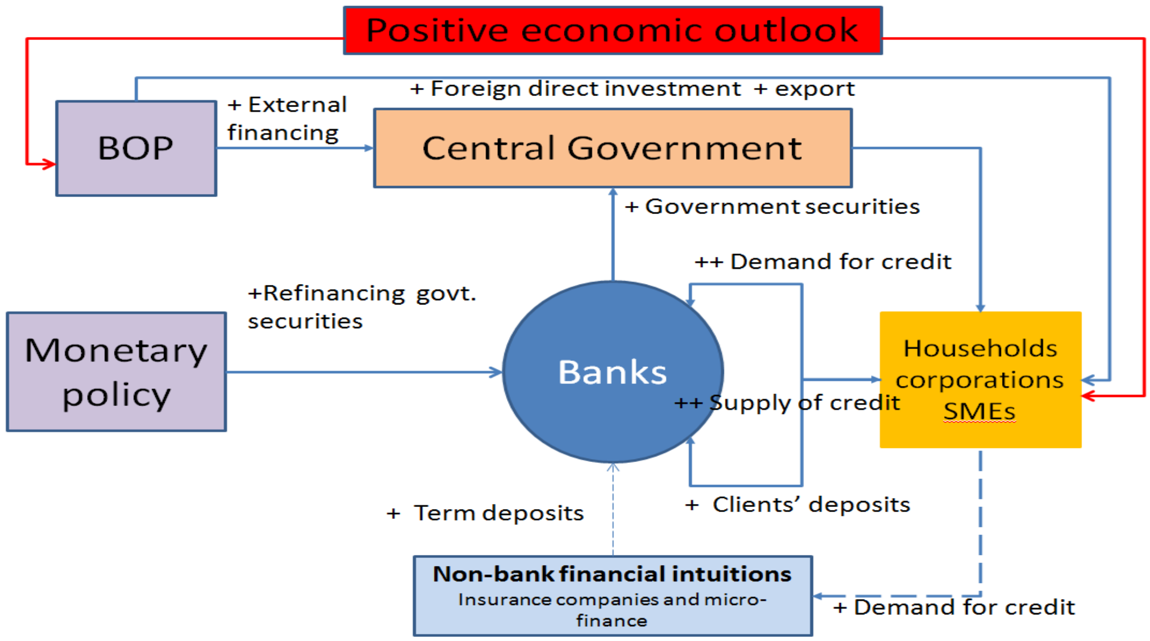
Figure 1. Credit, GDP, and CPI
(December 2010=100)



Source: BCEAO.

[1] Prepared by Romain Veyrune.

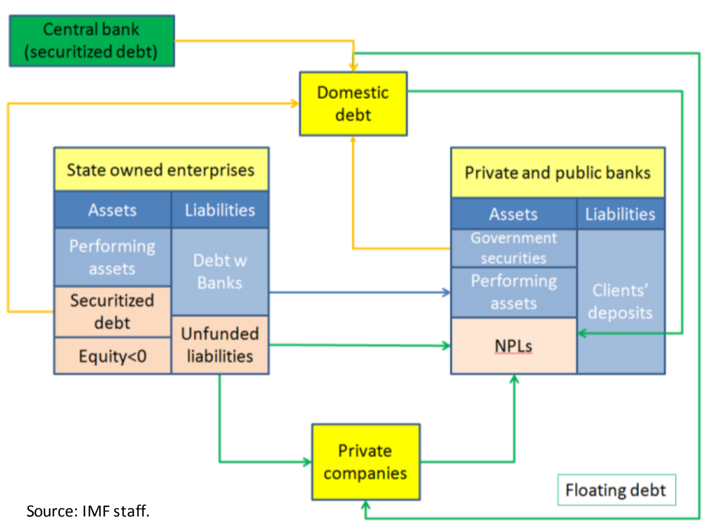
Figure 2. Côte d'Ivoire: Macro-Financial Linkages



Source: IMF staff.

2. Domestic debt management poses challenges to the stability of the financial sector. Côte d'Ivoire's domestic debt has three components: (i) goverment securities; (ii) non-marketable securitized debt; and (iii) unfunded liabilities of the public sector (Figure 3). Securitized debt has been used as as a solution for government or non-financial public companies' unfunded liabilities. Most domestic securitized debt (i.e., excluding BCEAO) has ended up on banks' balance sheet. However, such debt cannot be traded without an important discount, which hampers its liquidity and ultimately banks' solvency. Moreover, several public companies have important unfunded liabilities with their suppliers, which affect the suppliers' ability to repay their loans to the banks and thus undermines banks'asset quality.

Figure 3. Côte d'Ivoire: Linkages Between Public Enterprises and Banks



Source: IMF staff.

3. The financial sector could trigger a shock to the economy or reinforce the impact on the real sector of non-financial shocks.

- The financial sector could affect economic growth if expectations of the economic outlook were revised, leading to a tightening in financing conditions. Weaker private sector expectations of Côte d'Ivoire's economic outlook could lower risk appetite. An increase in risk aversion would lead to tighter domestic financing conditions, which would likely raise NPLs. However, the existing thin capital buffer would be insufficient to absorb a significant rise in NPLs, which would hamper banks' ability to expand private sector credit. The adverse impact on economic growth of a contraction in credit would increase as a result of the leverage of the non-financial sector, itself a consequence of the recent credit growth.

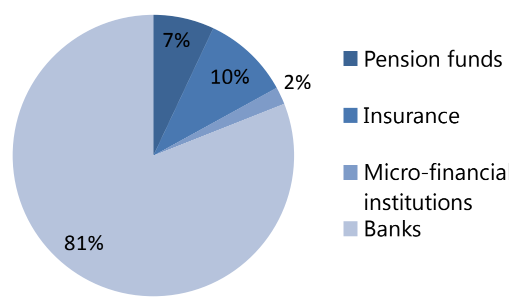
- The financial sector could amplify external or fiscal shocks. Deteriorating external conditions, such as terms-of-trade shocks, loss in access to international capital market, and a tightening of regional monetary conditions, would lower bank funding and private sector financing. In addition, reduced official access to international market, shortfalls in budget revenue, and unexpected fiscal expenditures would lead to either (i) increased government reliance on domestic financing, including through unfunded liabilities, which could crowd out private sector credit or (ii) reduced capital spending, which would lower credit demand. The contraction in credit to the private sector would exacerbate the downturn in economic activity triggered by external and fiscal shocks.

A. Financial Sector Overview

4. Banks hold most of the financial sector assets. Twenty-six banks manage about 80 percent of the financial sector assets, with the remaining controlled mostly by insurance companies (Figure 4). Côte d'Ivoire's insurance sector is the largest in the WAEMU region in term of asset size, but covers only a small part of the population. The microfinance sector, which is recovering from the socio-political conflict of the late 2000s, is small (2 percent of financial sector assets).

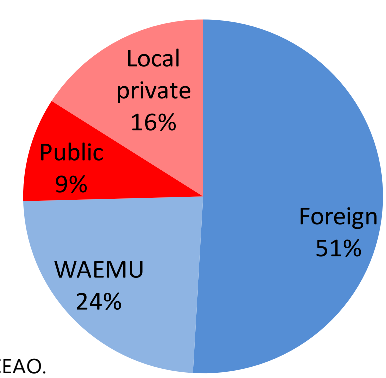
5. The banking sector is segmented along ownership and business models. Ten foreign-owned banks dominate the banking sector (Figure 5), followed by seven subsidiaries of regional banking groups and five locally-owned private banks. They operate as universal banks with strong links with large corporate clients. In addition, 4 public banks account for about 10 percent of the sector's assets, though their market share is shrinking as the state gradually disengages from the sector.

Figure 4. Côte d'Ivoire: Financial Sector Assets



Source: BCEAO

Figure 5. Côte d'Ivoire: Banks' Ownership



Source: BCEAO.
Note: As of June 2015.

6. Banking sector soundness indicators have deteriorated (Table 1):

- The average bank capital adequacy ratio fell to 8.3 percent at end-2015, only slightly above the WAEMU norm of 8 percent, as credit grew without a compensating increase in capital buffers. The aggregate capital adequacy figures mask the much-deteriorated solvency of one public bank, which drags the solvency of the sector down.

- Risks are concentrated on the five largest borrowers, which represent about a third of banks' assets and three-times their capital. These borrowers are large public and private companies, the latter in the agro-business and commerce sectors.

- After years of decline, the stock of NPLs increased by more than private sector credit in 2015, and the provisioning rate declined from 77 percent to 68 percent, resulting in a 75 percent increase of NPLs net of provision. The increase in NPLs appears to reflect bank credit to small and medium-size enterprises (SMEs), which have a high probability of default, and arrears from financially weak public companies.

- Most banks respect liquidity ratios. Public banks' liquidity ratios are relatively more deteriorated.

Table 1. Financial Stability Indicators, 2015
(Percent)

	Regulatory capital to weighted assets	Non-performing loans to total loans	Asset concentration to capital	Liquidity coverage ratio	Return on Assets	Net Stable Funding Ratio	Market share
Cote d'Ivoire - December 2015	8.2	10.6	..	..	..	..	
Cote d'Ivoire - June 2015	9.5	10.9	299.0	91.3	0.8	96	
Non-WAEMU banks	10.9	9.8	248.8	93.0	1	99	51
WAEMU banks	11.2	5.3	337.5	92.0	0.8	100	24
Locally-owned banks	11.1	8.7	387.4	92.0	0.7	110	16
Public banks	-5.2	31.2	232.4	82.0	-0.2	53	10
Memo item:							
WEAMU regulatory benchmarks	> 8	not applicable	<75	>75	not applicable	>50	not applicable
International regulatory benchmarks	>>8	not applicable	<25	>100	not applicable	>100	not applicable

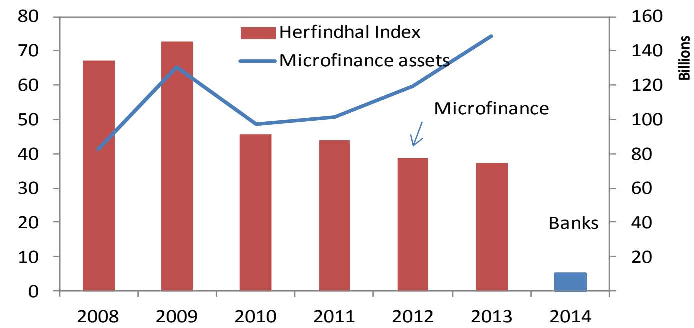
Source: Central Bank of West African States (BCEAO).

7. The performance of the microfinance sector is weakened by governance problems and a non-competitive structure. After a decline in 2010, microfinance assets grew from a low base at a rapid pace in line with the rest of the financial sector. The sector's negative capital has declined in terms of net assets, though about half of the 31 institutions remain insolvent, including the largest one. The microfinance sector is highly concentrated around one cooperative (Figure 6), which has a large number of members and an extensive network across the country. This cooperative, with shrinking market share, is under provisional administration and faces insolvency.

B. Financing of the Private Sector

8. Bank credit is the main source of funding for the non-financial private sector. The contribution of capital markets and non-bank financial institutions to private sector funding is limited owing to their limited size and insufficient development. Abidjan hosts the regional stock exchange, which has grown somewhat in size against the backdrop of strong economic growth, but has yet to become a major source of funding.

Figure 6. Côte d'Ivoire: Micro-Finance Indicators

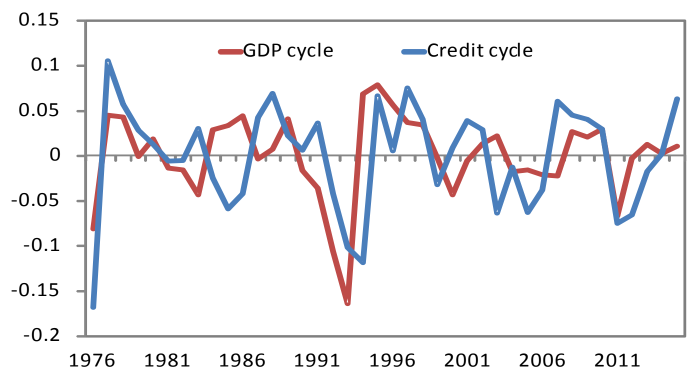


Source: BCEAO.

Note: The Herfindahl index is a measure of the size of firms in relation to the industry and an indicator of the amount of competition among them.

9. Credit has expanded significantly along with the strong economic performance and outlook. Data from 1976 to 2015 show a strong relation between the GDP and credit cycles with a lag of three to four years (Figure7). A Granger causality test indicates that the GDP cycle leads the credit cycle. The credit cycle usually spikes as the GDP cycle has already started to decline. Typically, a declining phase of the credit cycle is associated with increasing NPLs, which then linger on banks' balance sheet.

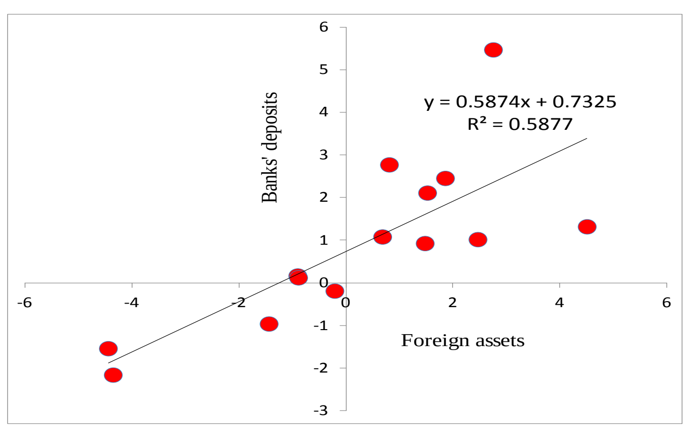
Figure 7. Côte d'Ivoire: Credit and GDP Cycles
(Hodrick-Prescott Decomposition, in percent)



Sources: Ivoirien authorities; BCEAO; and IMF staff estimates.

10. Since 2013, favorable external conditions have eased domestic financing conditions and supported GDP growth. Externally-financed government spending, foreign direct investment and robust cocoa export revenues have boosted GDP growth from 2012 to 2015. Corporate and customer deposits, as well as government deposits with some public banks, are banks' main source of funds. These deposits appear to be correlated with the balance of payment flows

Figure 8. Côte d'Ivoire: Banks' Funding and Balance of Payments
(Change, Percent of GDP)

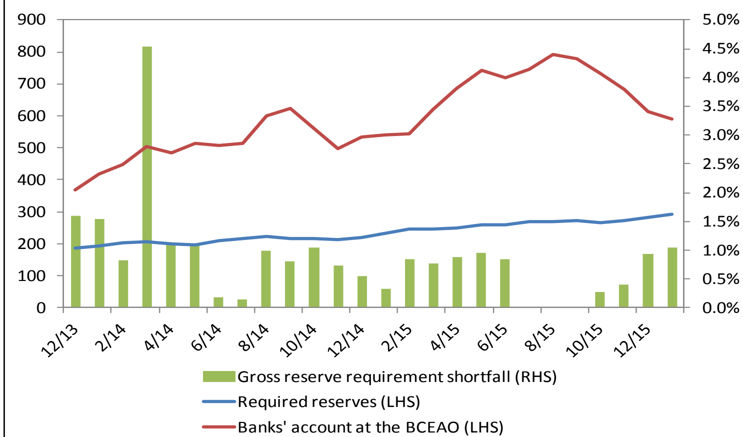


Source: BCEAO.

(Figure 8). The clearing of arrears and buy-back of domestic debt financed by external borrowing also eased local funding conditions. Accordingly, bank deposits increased by some 20 percent in 2014 and 2015, resulting in an easing of credit conditions.

11. Excess reserves at the BCEAO remain high. Banks' accounts at the BCEAO remained larger than twice the reserve requirement (Figure 9) in 2014 and 2015, reaching up to three times the requirement in August 2015. However, one to four banks regularly fail to maintain the required reserves, reflecting market segmentation, as well as the illiquidity of one bank. Excess liquidity could fuel credit booms. Clients' deposits, a costly resource base, financed unremunerated excess reserves, which, in turn, raised deposit costs leading to high lending rates. However, in the context of an optimistic outlook, banks are more willing to take additional risks by lending more to dispose of excess reserves in the market.

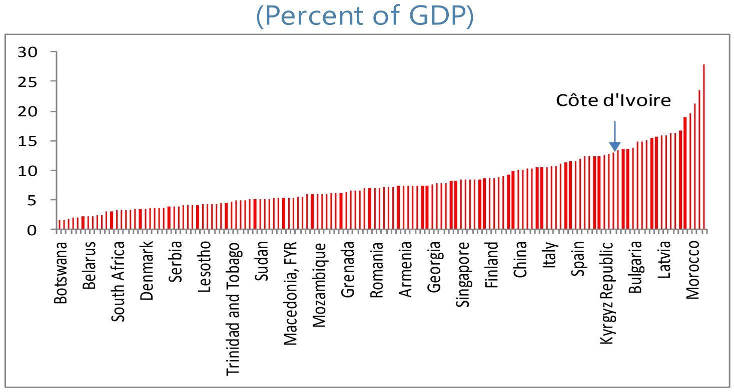
Figure 9. Côte d'Ivoire: Excess Liquidity



Source: BCEAO.
Note: Gross reserve requirement shortfall in percent of required reserves.

12. Mobilization of domestic savings by the financial sector remains subdued. The formal financial sector mobilizes only part of Ivoirien savings, with the remainder kept as cash at home or with informal financial institutions. Currency in circulation represents about 13 percent of GDP, placing Côte d'Ivoire among countries with a high preference for cash (Figure 10). In addition to the low deposits' remuneration due to excess reserves, the absence of long-term saving products, such as pension funds, life insurance institutions, and real-estate related saving, discourages saving in the formal sector.

Figure 10. Côte d'Ivoire and Comparators: Currency in Circulation
(Percent of GDP)



Sources: Central Bank of Western African States; and IFS.

13. The lowering of the transformation ratio has been associated with a surge in medium-term credit. The transformation ratio imposes a limit on long-term assets to long-term liabilities. It was reduced to 50 percent in 2015 (from 75 percent). While banks still primarily finance working capital with short-term loans (Table 2), data at end-October 2015 show medium-term credit growth exceeding short-term credit growth for the first time since 2010. The decline in the maximum transformation allowed a surge in medium-term loans, financed with short-term resources. As result, the possibility of a asset-liability mismatch has increased.

Table 2. Credit by Sectors, October 2015

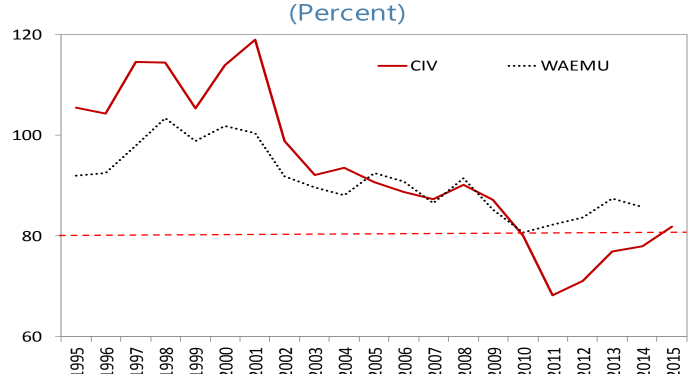
	Share of total credit	Contribution to credit growth
Commerce and services	34.6	26.6
Industry	23.8	29.0
Insurance, real estate	10.2	17.2
Transporation and communicat	9.4	-2.2
Agriculture	5.2	8.5
Household	3.1	1.2
Other	13.7	19.8
Memoradum items		
Private companies	90.0	86.5
Public companies	10.0	13.5
Short term	76.8	59.5
Medium term	21.6	39.0
Long term	1.6	1.5

Sources: BCEAO; and IMF staff estimates.
Note: Credit growth from October 2014 to October 2015.

14. Risks stemming from credit concentration on economic sectors remains limited. The main recipients of bank credit are the commerce, services, industry, and insurance sectors. New financing is going mainly to agro-business, wholesale trade, including crop finance, real estate, and private companies. Overall, credit growth appears relatively broad-based. About three-fifths of credit goes to the tertiary sector represents, with the remainder flowing mainly to the secondary sector.

15. Banks' leverage increased in the wake of the credit surge. After years of deleveraging, growth in credit to the private sector has exceeded deposit growth since 2011, resulting in an increase in the credit to deposit ratio to 81 percent (Figure 11). This level is above the prudent leverage of 80 percent. Accordingly, further credit growth should be supported by greater efforts to mobilize domestic deposits, especially if favorable external conditions abate.

Figure 11. Côte d'Ivoire: Credit to Deposits Ratio
(Percent)



Source: BCEAO.

16. Credit to the private sector is correlated with public investment. Public projects create business opportunities to contractors in different sectors. Banks provide short-term loans to suppliers based on public sector invoices, thus creating a strong link between public investments and private sector credit which may explain the large negative impact of official payment delays and arrears on banks' solvency. The link between public investment and private sector credit is supported empirically. The IMF's *SSA Regional Economic Outlook*[2] provides estimates of the drivers

[2] International Monetary Fund, *Regional Economic Outlook: Sub-Saharan Africa*, Washington, DC, April, 2016.

of private sector credit in Africa. Extending this exercise to include public capital spending and a qualitative (dummy) variable to control for the period after the debt relief under the enhanced HIPC Initiative shows such spending to be a significant driver of private sector credit (Table 3). In addition, debt relief by improving debt sustainability and easing access to international capital markets to finance capital spending also had a positive impact on credit to the private sector growth.

Table 3. WAEMU: Drivers of Credit to the Private Sector

Variables			
Lagged dependent variable	0.81***	0.83***	0.82***
	[0.02]	[0.02]	[0.03]
Openness	2.48***	3.02***	3.12***
	[0.78]	[0.75]	[0.77]
Real GDP per capita	4.03***	3.56***	3.52***
	[1.0]	[0.75]	[1.06]
Financial sector development index	21***	12.8	14.79
	[9.8]	[10.4]	[10.9]
Public capital formation	0.14***	0.15***	0.13***
	[0.04]		[0.04]
Public capital formation - CIV's specific coefficient	0.04		0.04
	[0.07]		[0.07]
After debt relief under the HIPIC initiative		0.9***	0.8***
		[0.39]	[0.31]
Observation	238	238	238
Number of countries	6	6	6

Standard errors in brackets.

Note: Based on an Arrellano Bond panel regression of data from 1975 to 2015 for eight WAEMU countries. ***p<0.05.

C. Domestic Financing of the Public Sector

17. The public sector has relied primarily on external funding over the recent years. Debt relief in 2012 under the enhanced HIPC Initiative completion point and MDRI improved Côte d'Ivoire's debt sustainability as external debt declined significantly, and since then debt has been assessed to be at moderate risk of distress. Côte d'Ivoire has used external borrowing (mostly on non-concessional terms) to finance its investment plan.

18. Banks are the main domestic source of public sector financing:

- The government's main domestic funding instruments are medium-term securities, which are issued in approximately equal proportion via the BCEAO auction mechanism in the regional market and via private placement through Abidjan stock exchange. Banks are the main buyers of government securities, which are held to maturity as the secondary market is inactive. The stock of government securities reached about 14 percent of GDP in 2014 from less than six percent in 2010 and stabilized at this level as the authorities issued sovereign bonds in international capital market.

- The government has accumulated a stock of securitized debts, which are arrears converted into a debt instrument at below the market conditions in terms of interest rates, grace periods, and maturities (i.e., non-marketable without significant discount). This debt reached about 5 percent of GDP in 2015, and was contracted with a variety of counterparties, such as the BCEAO (57.4%), banks (29.7%), and non-financial companies (12.8%). Non-financial companies have used the securities as collateral for bank loans.

- The government, which relies on floating debt to manage its cash flow, has three months to pay its bills before the payment is considered overdue. The float stood at slightly over one percent of GDP at end-2015.
- About 43 percent of state-owned companies funding comes from local banks. Reliance on domestic funding increases as these companies' financial condition deteriorates.
- Recourse to unfunded liabilities with (foreign) suppliers is large for one public company. These liabilities are gradually converted into banks' loans as the company's payments obligation becomes due. These loans (often collateralized with securitized debts) are regularly amongst the banks' 10 largest exposures, reaching up the 5.9 percent of banks' total credit in 2015.
- The negative net value of some financial institutions represents another stock of unfunded liabilities. Based on available 2015 data, the negative value of financial institutions, including public banks and microfinance entities, government' arrears vis-à-vis public banks, and liquidated institutions' liabilities, reached about 1.3 percent of GDP. The final cost for the budget would depend on the resolution strategy that the authorities will adopt.

19. Securitized debt has limited value for the financial sector. The securities cannot be traded in the market for liquidity without bearing a capital loss that would affect bank's solvency. They typically include relatively long grace periods and lower than the market interest rates, which reduce the cash flow compared to other government securities. The main advantage of securitized debt is that it can be used as collateral.

20. Public sector unfunded liabilities pose a challenge to financial stability and a fiscal risk. The concern for financial stability relates to banks' exposure to public enterprises facing financial difficulties and to the impact on asset performance of payment delays. The government budget would need to address public enterprises' unfunded liabilities and introduce reforms to improve their efficiency in order to improve the financial health of these companies and to avoid a further deterioration in banks' balance sheet.

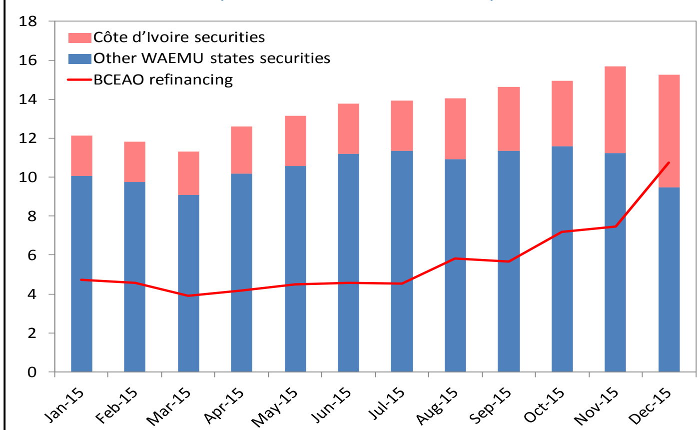
21. Banks have seized the carry trade opportunity offered by the BCEAO's refinancing of government securities. Since 2013, the BCEAO has refinanced government securities with maturities of greater than five years, which yield about six percent, at 2½ percent in unlimited amounts. It offers to banks the opportunity of funding their purchases of long-term government securities with seven-day low-cost BCEAO's loans, which through 2015 increased to 11 percent of bank's total assets. This policy has increased the demand for refinancing. In addition, it may create a maturity mismatch due to the funding of long-term securities with short-term rate loans. Out of 26 banks, 13 appear to have used this opportunity at end-December 2015 (up from nine in June

2015). Two of them, representing about ten percent of the sector assets, have built their government securities portfolio up to half of their total assets.

22. Banks in Côte d'Ivoire have increased their exposure to sovereigns in the region (Figure 12). In 2015, these banks (mainly smaller regional ones) doubled their holdings of other WAEMU governments' securities[3] to 38 percent of their securities portfolio. Meanwhile, the stock of Côte d'Ivoire's securities declined slightly, reflecting less issuance by Côte d'Ivoire in the regional market as a result of greater recourse to external financing. Ivoirien banks with an important portfolio of securities of other WAEMU governments appear to have significantly more BCEAO refinancing (Table 4). This likely reflects a BCEAO-financed search for yield in the regional market.

Figure 12. Côte d'Ivoire: Sovereign Exposure and BCEAO Refinancing, 2015

(Percent of banks assets)



Source: BCEAO.

Table 4. Côte d'Ivoire: Elasticity of BCEAO Refinancing to Government Bonds

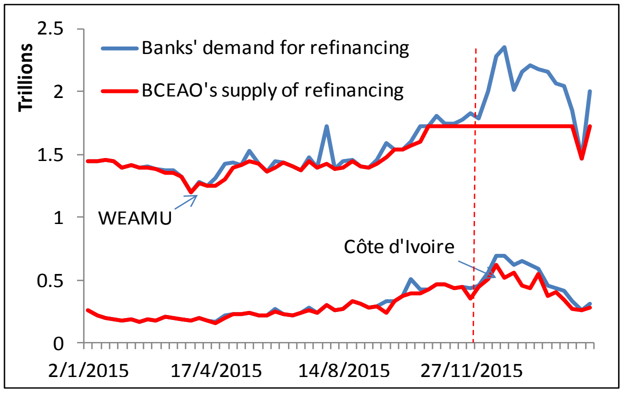
Variables (in log)	BCEAO refinancing (in log)
Constant	-0.65
	[1.37]
CIV securities	1.005***
	[0.13]
Other WAEMU securities	1.11***
	[0.15]
Observation	117
Number of months	12
Number of banks	6

Standard errors in brackets.
Note: Based on fixed effect panel regression of monthly data in 2015 for CIV banks. ***p<0.05.

23. A tightening in monetary policy would be transmitted via the public debt market. At end-2015, the BCEAO leveled off its refinancing of government securities (Figure 13), leading to an excess demand for its refinancing operations and a 50 basis point increase in short-term rates (Figure 14).

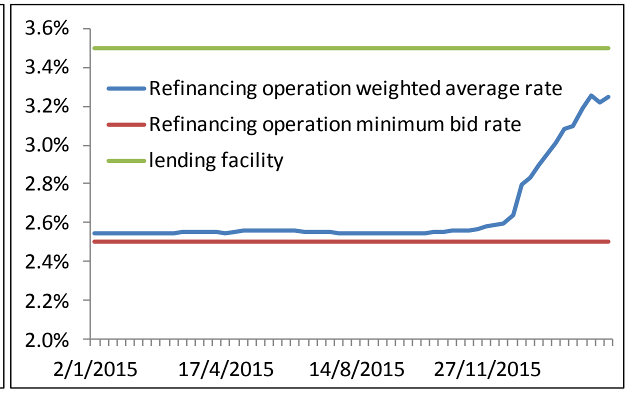
[3] Government securities in the WAEMU region carry a zero-risk weight.

Figure 13. BCEAO Refinancing



Sources: BCEAO; and IMF staff estimates.

Figure 14. BCEAO Short-Term Interest Rate



Sources: BCEAO; and IMF staff estimates.

D. Restructuring the Public Banking Sector

24. **Public banks, the financially weakest segment of the financial sector, are undergoing restructuring**. Under the weight of non-performing loans, the negative net value of their balance sheet, and management weaknesses, most public banks are unable to extend financing to the economy. These banks are in the process of being restructured:

- The minority public sector stakes in two smaller banks were sold. The authorities successfully liquidated the public agricultural bank in an out-of-court process. Two other public banks are slated for privatization in 2016. The authorities intend to retain two public banks, which either play a significant role in the rural areas or provide credit to sectors where private banks do not have large presence.

- The savings bank will be restructured. The bank, with 131 branches, is viewed by the government as being important for access to finance, including salary payments, in the 56 remote areas where it is the only institution providing banking services. However, its income covers just a third of the costs and only 10 percent of the deposits has been invested in performing assets. The bank is insolvent and making losses.

25. **The IMF and World Bank technical assistance reviewed the different resolution options for the saving bank**. Two options[4] are (i) an out-of-court liquidation, following the model used for another public bank, and (ii) a purchase and acquisition. In both options, the objective would be to cease the bank's activity—to minimize the fiscal cost of its resolution—and transfer its performing assets and some branches to one or several other financial institutions.

26. **Given its importance for financial inclusion, the authorities have decided to continue the savings bank's activities**. They estimate the restructuring cost at CFAF 35 billion. Differences

[4] They would cost less than CFAF 53 billion compared to more than CFAF 95 billion if the CNCE were to continue its activities.

between the authorities and technical assistance cost estimates relate to the value of the bank's assets and non-performing loan recovery.

27. The public investment bank's exposure to the public sector is large, amounting to more than 40 percent of its assets. More than half of the public debt to the investment bank, including loans to public companies and government's securitized debt, is overdue. An important share of the liabilities of small- and medium-sized enterprises (SMEs) in default is due to past government payment delays to suppliers indebted with the investment bank. The authorities consider that the bank's situation will be resolved with a conversion of the bank's public sector unfunded liabilities into a new securities debt with longer maturities and new grace period.

E. Recommendations

28. Carefully monitor risks related to the rapid credit growth. The current risk appetite should be carefully monitored on a bank-by-bank and sector-by-sector basis.

29. Encourage banks to build up capital buffers to address credit risk due to rapid credit growth. Staff supports the BCEAO initiative to increase banks' minimum capital and encourages the authorities to assist the BCEAO with a rapid implementation of the measure.

30. Complete the restructuring of public banks. The selected restructuring options should achieve solvency after restructuring and guarantee a viable business model, including via budgeted subsidies if social but low-profit activities are kept in the public banks' business models.

31. Develop a domestic debt strategy to convert securitized debt into marketable securities. Preparation of a preannounced program of regular issuances of medium-term securities (two to seven years) with weekly issuances on the regional market would be useful. The proceeds could serve to buy back securitized debt, an operation that would not change the amount of domestic debt but could modify its distribution among banks.

32. Settle unfunded liabilities. Settling public sector' unfunded liabilities would strengthen the financial sector's solvency, especially for public banks. The settlement should be accompanied by the reform of public non-financial institutions to restore their financial viability. The Treasury should introduce active cash flow management based on a single Treasury account, with the preparation of short-term provisional cash flow forecasts, and the regular issuance of short-term maturity debt instruments (one to nine months) to reduce float and payment delays. In addition, government securities should be used by the government instead of securitized debt to address arrears vis-à-vis public banks and state-owned companies' unfunded liabilities.

33. Continue efforts to encourage the mobilization of domestic savings. Finalizing the single Treasury account and converting securitized debt into government securities would reduce excess liquidity, thereby supporting deposit mobilization and development of the interbank market. Enlarging the domestic funding base will make credit supply less dependent on external conditions.

ENHANCING FINANCIAL INCLUSION[1]

Côte d'Ivoire's financial inclusion indicators generally point to relatively low inclusion as well as geographical and gender disparities. The strong penetration of mobile networks presents an opportunity to enhance financial inclusion and will require regulatory reforms aimed at promoting the development of technology-based financial services, which would contribute to stronger, diversified and inclusive growth.

A. Background

1. **There is a strong link between financial inclusion and economic development**.[2] Greater availability of, and access to, financial services gives households and firms better access to credit and facilitates transactions, thus broadening the sources of growth and making it more inclusive. Identifying the main constraints to financial inclusion and implementing measures to address them strengthens growth, makes it more sustainable, and reduces inequality.

2. **Competition policy for financial services is an important factor that contributes to greater financial inclusion:**

- A market for financial services that is open to fair competition fosters financial inclusion by encouraging more providers to enter the market for financial services and avoiding the emergence of companies with excessive market power, thereby enabling a greater variety of services and lower costs.

- An interoperable financial system would also enhance competition. Greater financial inclusion can be facilitated by a fully interoperable financial system, in which any user of a digital network can transact with any other. In some cases, interoperability will emerge as a market solution; in others, it may need to be encouraged by regulatory reforms.[3]

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[1] Prepared by Carla Macario (IMF), with contributions from Caroline Cerruti Hailey and Marco Traversa (both World Bank). This paper has benefitted from comments from Larry Qiang Cui.

[2] Dabla-Norris, Ji, Townsend and Unsal (2015), "Identifying constraints to Financial Inclusion and their Impact on GDP and Inequality: A Structural Framework for Policy", *IMF Working Paper*, WP/15/22, January 2015; IMF, West African Economic and Monetary Union, Selected Issues (2015), *IMF Country Report No. 15/101*, April 2015; Mlachila, Montfort and others (2016), "Financial Development and Sustainable Growth", *Sub-Saharan Africa Regional Economic Outlook,* April 2016.

[3] Claessens, S. and Liliana Rojas-Suarez (2016), *Financial Regulations for Improving Financial Inclusion,* Center for Global Development Task Force Report, Washington.

B. Financial Inclusion in Côte d'Ivoire

4. Côte d'Ivoire's financial inclusion indicators generally point to a relatively low inclusion as well as geographical and gender disparities. Côte d'Ivoire's access to finance is lower than for sub-Saharan African frontier market economies.[4] Only about 15 percent of adults have an account in a financial institution. Access to financial services is also marked by sizeable gender and rural/urban disparities, consistent with the large income and education inequalities for these groups identified in the 2015 household survey. The financial inclusion gender gap (measured by accounts at a financial institution) is about 6 percent. The rural/urban gap is even higher: 10 percent of adults in rural areas have an account in a financial institution compared to about 20 percent of adults in urban areas (Figure 1). Access to financial services in rural areas is very limited as most banks and micro-financial institutions are located in urban areas.

5. Côte d'Ivoire's strong mobile phone penetration presents an opportunity to foster stronger financial inclusion through the development of technology-based financial services. The share of mobile cellular subscriptions per 100 people in Côte d'Ivoire increased from 13 in 2005 to 95 in 2013.[5] Côte d'Ivoire is the largest market in the WAEMU for mobile transactions, which increased by 20 percent between December 2014 and September 2015.[6] Mobile accounts are used for a wide range of transactions including the payment of school fees via mobile phones, and increasingly, for cross-border remittances. Other possibilities being explored by the authorities, with World Bank support, include tax payments via mobile phones. However, not all mobile accounts are active, in part because of the high price of services.[7]

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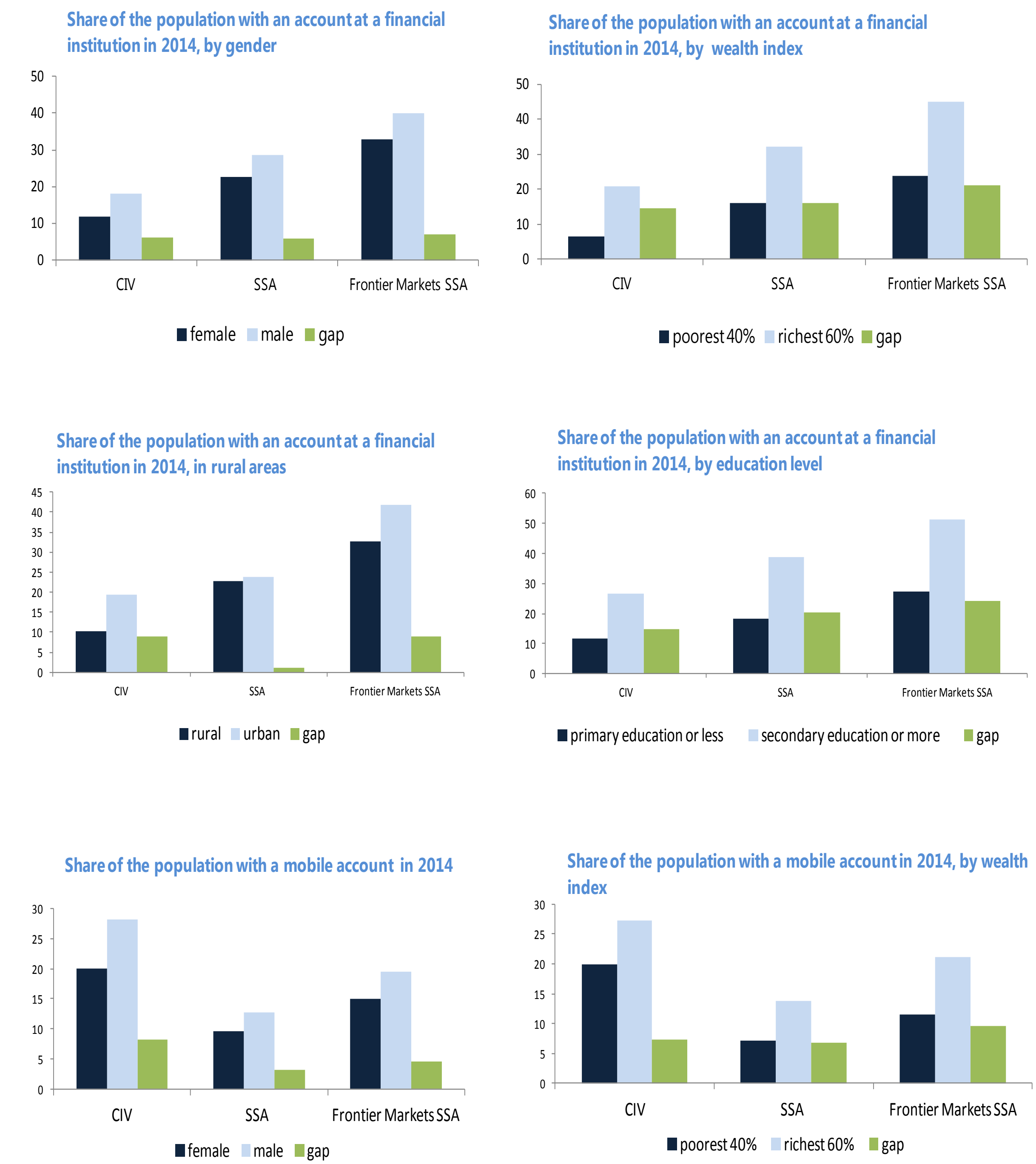
[4] Frontier markets are countries that have been able to tap international capital markets, but have financial markets that are not as deep and liquid as those of emerging markets (https://blog-imfdirect.imf.org/2014/05/19/the-new-frontier-economies-on-the-rise/).

[5] World Bank, *World Development Indicators*.

[6] BCEAO.

[7] IFC, *The mobile banking customer that isn't: drivers of digital financial services inactivity in Cote d'Ivoire.*

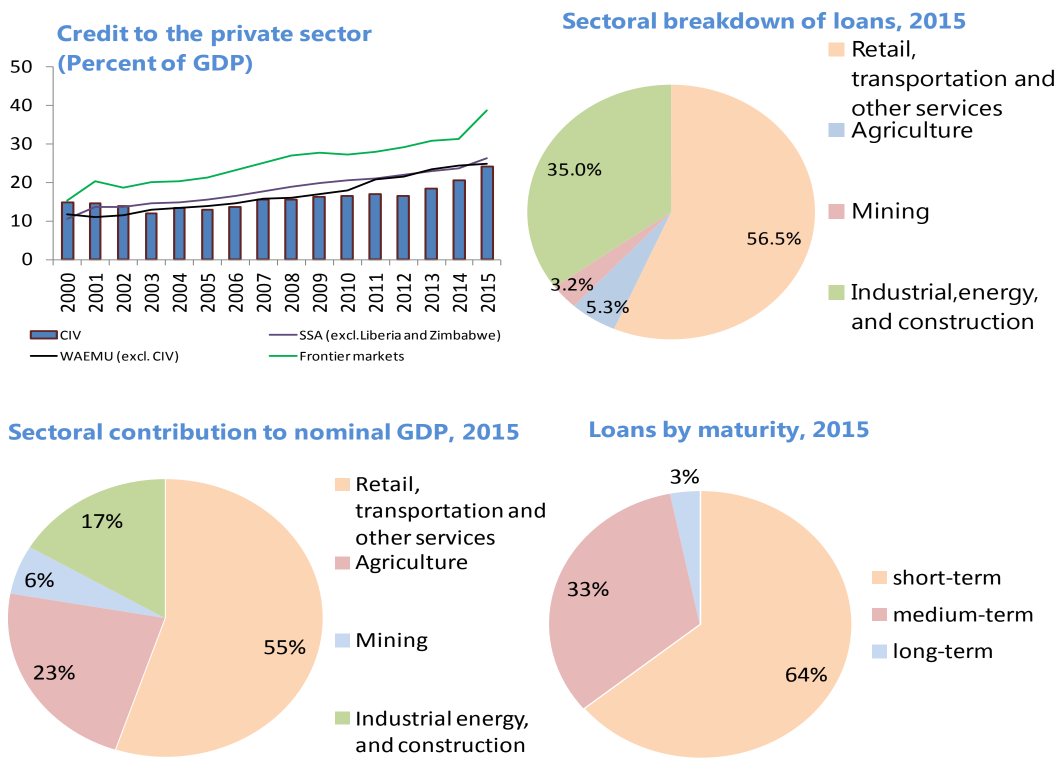
Figure 1. Côte d'Ivoire: Financial Inclusion Indicators



Source: World Bank Findex database.

6. The uneven credit creation by economic sector hinders broad-based growth (Figure 2). Credit to the private sector, while growing at high rates in recent years, is still below that of frontier economies. Also most loans are made to commerce and services, which is out of line with the structure of the economy. As a result the agricultural sector receives only about 5 percent of credit even though it accounts for almost a fourth of the economy's GDP and is a key contributor to growth, employment and income in rural areas, with important spillovers to the rest of the economy.

Figure 2. Côte d'Ivoire: Credit to the Economy

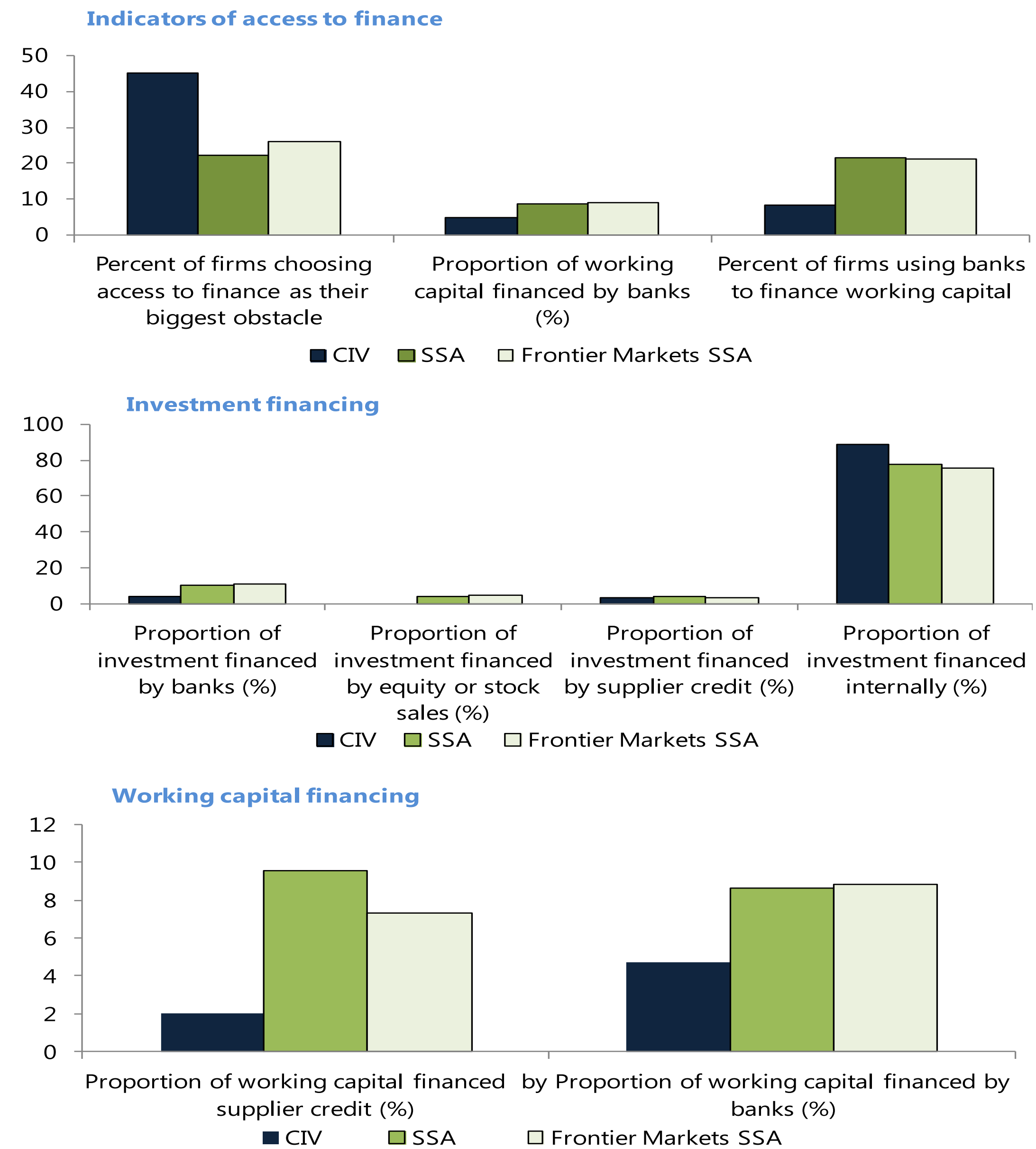


Sources: IFS; and IMF staff calculation.

7. The constraints to obtaining financing faced by Ivoirien firms are considerable and higher than in comparable countries (Figure 3). Indicators related to financing for SMEs are weaker for Côte d'Ivoire than for comparable countries, and difficulties in obtaining financing are the main obstacle to doing business.[8] The limited access to funds to finance investment, in particular from banks, leads to a high share of firms self-financing their investment.

[8] World Bank Enterprise Surveys, latest year available.

Figure 3. Côte d'Ivoire: Small- and Medium-Size Enterprise Access to Credit



Source: Financial Access Survey, IMF.

8. The weak financial health of the public banks has contributed to the low financial inclusion.[9] In particular, the financial difficulties faced by the savings bank, which has a

[9] See Selected Issues Paper on macro-financial linkages.

geographically wide and extensive number of account holders (over 300,000), have restricted its ability to provide a wide variety of services to its widespread clientele.

9. The micro-finance sector has considerable potential to provide financial services to low-income households and firms. The sector is heterogeneous and located predominantly in urban areas:

- As of September 2015, there were 62 micro-financial institutions, with almost one million members, essentially all in urban areas. They provide short-term loans and working capital mainly for commerce and to households.

- The largest micro-finance institution (UNACOOPEC-CI) has about 635 thousand members. However, with large losses and negative capital, it has been under provisional administration since September 2013.

- The supervisory authority has taken steps to strengthen the sector by withdrawing the licenses of several micro-financial institutions. Other measures to improve the sector's governance include strengthening supervision with technical assistance (e.g., Agence Française de Développement) and training to improve reporting standards and practices.

- The sector has some modern and sound micro-financial institutions, including Credit Access, Advans-CI and Microcred-CI, some of which are branches of international micro-financial institutions. These are providing short-term loans and working capital to low-income households and firms and have begun to expand to rural areas, particularly those with cocoa farms.

- Some of the modern micro-financial institutions are working together with telecommunication companies to provide services through mobile networks.

10. Additional constraints to financial inclusion and the development of the financial sector include: an inadequate property and land registry; difficulties in repossessing collateral in the event of loan defaults, in particular through the judicial process; lack of information on the creditworthiness of borrowers; high fees for basic banking services; and low levels of financial education.

C. Policies to Enhance Financial Inclusion

11. To address these obstacles to financial inclusion and promote a greater role for the financial sector in supporting growth, the authorities formulated a financial sector development strategy (FSDS) with World Bank assistance. The strategy, approved by the government in March 2014, aims to strengthen the stability of the financial sector and to promote its development (Box 1). It is a key component of the authorities' plan to make higher private investment the key driver of growth.

Box 1. Côte d'Ivoire: Financial Sector Development Strategy (FSDS)

The main components of the strategy include the following, several of which are critical for enhancing financial inclusion:

- Restructuring public banks;
- Strengthening the transparency of financial information;
- Deepening the financial market by diversifying the capital market;
- Increasing the professionalism of the microfinance sector and preserving UNACOOPEC-CI;
- Increasing SME access to credit and to leasing;
- Fostering credit for mortgages;
- Regularizing traditional or customary land tenure;
- Organizing producer associations, rationalizing access to guaranty funds and developing a strategy to finance subsistence agriculture;
- Strengthening the supervision of insurance and broadening insurance coverage to a larger share of the population.

12. The strategy to improve financial inclusion is being supported by the World Bank through:[10] (i) a Financial Sector Strengthening Initiative (FIRST) project on financial stability and inclusion; (ii) a FIRST project on affordable housing-finance in the WAEMU region; (iii) assistance to set up the regional credit bureau; (iv) a sustainable leasing infrastructure program with a new regulatory framework and assistance to leasing institutions; (v) a financial inclusion support framework (FISF) focused on monitoring inclusion, digitalization of government payments, modernization of agent banking regulation and microfinance law, agriculture finance, and financial consumer protection.

13. Regulatory reforms that have been implemented should contribute to increasing financial inclusion through the development of technology-based financial services:

- The 2012 telecommunications reform expanded the coverage of Côte d'Ivoire's telecommunications regulatory authority to include mobile banking;
- In May 2015, a BCEAO instruction updated the regulatory framework for issuers of mobile money in the WAEMU and permitted telecom companies to issue electronic money without being linked to a financial institution.

14. Further reforms would foster the supply of a wide variety of financial services, in particular through digital networks. Specific areas of reform could include:

[10] The World Bank is supporting the Ivoirien authorities with reforms to improve financial inclusion, and plans to support the regional authorities with the implementation of the BCEAO's Regional Financial Inclusion Strategy.

- Modernizing micro-finance law and regulations to allow micro-finance institutions to take advantage of recent innovations (such as leasing e-money products) to facilitate the provision of a diverse and appropriate range of products for small- and medium-sized enterprises and individuals, and to facilitate the restructuring of micro-finance institutions.

- Ensuring adequate competition in the mobile financial services market and retail agents:

  - Telecommunication companies control access to mobile networks for mobile financial services, including for the Unstructured Supplementary Service Data (USSD) connectivity platform.[11] They are thus free to determine whether to grant access to their network to a financial institution offering services, as well as the price and quality level at which they provide access.

  - The role of telecom companies as gatekeepers to mobile networks gives them a competitive edge over financial institutions in the provision of mobile banking services. Such market asymmetry favors telecommunications companies and may put financial institutions, including those providing services to lower income customers, at a disadvantage. Market asymmetry also curtails incentives to invest in technology platforms, thereby limiting the variety of services that can be offered to customers.

  - If consumers are to have access to a wide range of financial services through the mobile networks, the telecommunications regulator, in coordination with the BCEAO, must guarantee fair access of financial institutions to mobile networks. In this context, providing fair access to mobile network channels, including for USSD, is important.[12]

- Issuing regulations to facilitate the use of bank agents (in post offices or grocery stores, for example, to represent financial institutions outside of branches) or correspondent banking. International experience demonstrates that this has contributed significantly to improving financial inclusion, particularly in rural areas.[13]

- Transitioning government payments to an electronic system, in line with international experience and guidance.[14]

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[11] USSD is a critical element of the infrastructure needed for low-cost mobile financial services on nearly any phone and the conditions for access will have an impact of the development of a wider variety of financial services.

[12] See also: http://www.cgap.org/publications/promoting-competition-mobile-payments-role-ussd and http://www.cgap.org/blog/why-equity-bank-felt-it-had-become-telco-%E2%80%93-reluctantly.

[13] World Bank (2014), *Financial Inclusion*, Global Financial Development Report, Washington.

[14] See http://www.bis.org/cpmi/publ/d133.htm.

- Encouraging reforms that allow for comparability of financial services and products. In this context, steps to increase transparency by publishing in a comparable fashion fees and terms and conditions would be useful. Such reforms would increase the understanding of consumers, facilitate the use of a wide variety of financial services, and may lower the price of financial services as happened in other countries.

- Strengthen the framework for financial consumer protection. While the rapid growth of new financial service providers such as mobile money issuers can help fulfill important financial inclusion objectives, it also brings risks to consumers, particularly those with low levels of financial capability who often do not fully understand the products they use or the rules of the relationship with a formal financial service provider. Financial consumer protection measures can help mitigating these risks.

- Develop financial education programs to foster confidence of new users in the formal financial system.